American
Iron and Steel
Institute

1140 Connecticut Avenue, NW
Suite 705
Washington, DC 20036-4700
Phone 202.452.7100
Fax 202.466.7052

www.steel.org

January 25, 2006

Case No.: A-823-812
Total Pages: 102

PUBLIC DOCUMENT

David Spooner
Assistant Secretary for Import Administration
Attention: Import Administration
Central Records Unit, Room 1870
U.S. Department of Commerce
14th Street and Constitution Avenue, N.W.
Washington, D.C. 20230

Re: Inquiry into the Status of Ukraine as a Non-Market Economy Country for Purposes of the Antidumping Law

Dear Assistant Secretary Spooner:

The American Iron and Steel Institute ("AISI"), on behalf of its U.S. member companies, hereby makes this submission in response to the Department's request for further comments on the issue of whether Ukraine should continue to be

treated as a non-market economy ("NME") country for purposes of the antidumping law.[1]

In response to the Department's request, AISI submitted initial comments on the issue of Ukraine's status as an NME country on July 11, 2005 and rebuttal comments on that issue on August 31, 2005.[2] In both of these submissions, AISI conclusively demonstrated that Ukraine has not satisfied any of the six statutory factors set forth in Section 771(18)(B) of the Tariff Act of 1930, as amended, to be considered a market economy for purposes of the U.S. antidumping law.[3] The additional information presented herein is intended solely to supplement, rather than replace, the information provided in AISI's previous comments. In fact, the materials attached to these comments establish that there have been no changes or developments since the submission of AISI's previous comments that would warrant treating Ukraine as a market economy.

---

1 Changed Circumstances Review of the Antidumping Duty Order on Carbon and Certain Alloy Steel Wire Rod From Ukraine: Opportunity to Comment on the Status of Ukraine as a Non-Market Economy Country and Extension of Final Results, 71 Fed. Reg. 2904 (Dep't Commerce Jan. 18, 2006) (request for comments and extension of final results).

2 See Comments Submitted by the American Iron and Steel Institute Regarding the Non-Market Economy Status of Ukraine (July 11, 2005) (Public Document); Rebuttal Comments Submitted by the American Iron and Steel Institute Regarding the Non-Market Economy Status of Ukraine (Aug. 31, 2005) (Public Document).

3 See id.

To the contrary, the materials attached hereto demonstrate that Ukraine continues to be an NME country. In particular, these materials show, among other things, the following:

- The "2006 Index of Economic Freedom" report on Ukraine shows that the country's overall index remains in the report's "mostly unfree" category.[4] Indeed, Ukraine again received an overall score of 4.0 (out of 5.0) for "capital flows and foreign investment," thereby indicating a high level of barriers to foreign direct investment.[5]

- A November 2005 study by the World Bank concludes that most labor is still employed in the public sector in Ukraine and that "{w}ages still are determined in a rather centralized way, especially in public and privatized firms."[6] The study also concludes that Ukraine's labor market dynamics are limited and that the market is characterized by a low level of labor mobility.[7] Furthermore, the study addresses the poor investment climate in Ukraine and concludes that "the key to improving labor market outcomes is to remove {the} main impediments to entry of and growth by firms, such as policy uncertainty, corruption, red tape, inefficient regulations and poor access to finance."[8]

- The State Statistics Committee of Ukraine reports that the already enormous level of wage arrears in the country actually increased slightly in 2005 from 1.1112 billion hryvnyas in January 2005 to

---

4 "2006 Index of Economic Freedom - Ukraine," Heritage Foundation, available at http://www.heritage.org/research/features/index/country.cfm?id=Ukraine (last visited Jan. 24, 2006) at 387, attached as Exhibit 1.

5 Id. at 388.

6 "Ukraine Jobs Study - Forecasting Productivity and Job Creation," World Bank (Nov. 30, 2005), at Vol. I, pp. 1, 3, attached as Exhibit 2.

7 Id. at Vol. I, p. 1.

8 Id.

1.1134 billion hryvnyas in December 2005. Clearly, no progress has been made in combating this significant problem in Ukraine.[9]

- According to the World Bank Group, Ukraine currently ranks 124th out of 155 countries on the overall ease of doing business in the country and 141st out of 155 countries on its protection of investors.[10]

- Finally, a December 2005 report by Transparency International shows that corruption continues to be a serious concern in Ukraine.[11]

As demonstrated by these materials and in the previous comments submitted on behalf of AISI, Ukraine does not satisfy any of the conditions necessary to be treated as a market economy. Accordingly, the Department should continue to treat Ukraine as an NME country for purposes of the antidumping law.

Respectfully submitted,

Barry O. Solarz

Barry Solarz
Vice President, Public Policy, Tax, Trade

cc: Lawrence Norton
Shauna Lee-Alaia

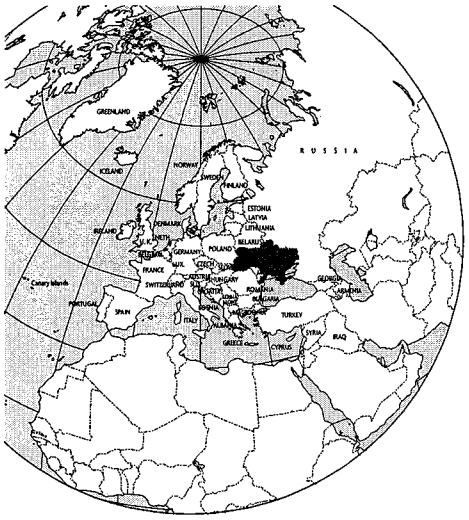
---

[9] See "Wage Arrears by Region, 2005," State Statistics Committee of Ukraine Website, available at http://www.ukrstat.gov.ua/operativ/operativ2005/gdn/zvz/zvz_e/zvz2005_e.html (last visited Jan. 20, 2006), attached as Exhibit 3.

[10] "Doing Business - Explore Economies," World Bank Group, available at http://www.doingbusiness.org/ExploreEconomies/Default.aspx?economyid=194 (last visited Jan. 19, 2006), attached as Exhibit 4.

[11] See, e.g., "Report on the Transparency International Global Corruption Barometer 2005," Transparency International (Dec. 9, 2005) at pp. 4-5, 15, attached as Exhibit 5.

EXHIBIT 1

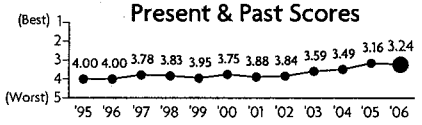


UKRAINE

Rank: 99

Score: 3.24

Category: Mostly Unfree



QUICK STUDY

SCORES

Trade Policy	2.5
Fiscal Burden	2.9
Government Intervention	2
Monetary Policy	3
Foreign Investment	4
Banking and Finance	3
Wages and Prices	3
Property Rights	4
Regulation	4
Informal Market	4

Population: 48,355,700

Total area: 603,700 sq. km

GDP: $39.3 billion

GDP growth rate: 9.4%

GDP per capita: $812

Major exports: metals, minerals, electronics, chemicals, vegetables, fuel and petroleum products

Exports of goods and services: $24.2 billion

Major export trading partners: Russia 17.8%, Germany 5.9%, Italy 5.3%, China 4.1%

Major imports: minerals, electronics, transport equipment, metals

Imports of goods and services: $22.3 billion

Major import trading partners: Russia 35.9%, Germany 9.4%, Turkmenistan 7.2%

Foreign direct investment (net): $1.3 billion

2003 Data (in constant 2000 US dollars)

In 2004, Ukraine's political system was gripped by the struggle to succeed President Leonid Kuchma, whose nine-year rule expired amid malaise and corruption. The "Orange Revolution" ended with former Prime Minister Viktor Yushchenko claiming victory as president after a December rerun of October's rigged elections, beginning a new chapter of bold political and economic change. The Yushchenko administration has dedicated itself to bringing to justice those responsible for the murder of journalist Georgii Gongadze five years ago. It also has openly expressed its pro-Western stance, pushing for closer relations with the European Union and NATO. Perhaps most important, the government has embarked energetically on policy reforms, although such reforms often do not follow the principles of free markets, privatization, tight monetary policy, low taxes, and property rights. Despite significant dependence on energy imports from Russia, Ukraine continues to seek an equal trading relationship with its neighbor. The economy grew an impressive 12.1 percent in 2004, according to the Economist Intelligence Unit, but high oil prices, increased inflation (now at 13 percent), and political unrest were responsible for an economic slowdown at the beginning of 2005. Ukraine's government intervention score is 0.5 point better this year; however, its fiscal burden of government score is 0.3 point worse, and its monetary policy score is 1 point worse. As a result, Ukraine's overall score is 0.08 point worse this year.

TRADE POLICY

Score: **2.5**–Stable (moderate level of protectionism)

According to the World Bank, Ukraine's weighted average tariff rate in 2002 (the most recent year for which World Bank data are available) was 3.9 percent. (The World Bank has revised the figure for 2002 downward from the 4.4 percent reported in the 2005 *Index*.) The U.S. Department of Commerce reports that Ukraine continues to maintain import barriers, including "discriminatory fees and certification regimes. Non-tariff barriers include non-transparent standards, cumbersome procedures for phytosanitary certification, and import licenses." Based on the revised trade factor methodology, Ukraine's trade policy score is unchanged.

FISCAL BURDEN OF GOVERNMENT

Score—Income Taxation: **1.5**–Stable (low tax rates)

Score—Corporate Taxation: **3**–Stable (moderate tax rates)

Score—Change in Government Expenditures: **4**–Worse (moderate increase)

Final Score: **2.9**–Worse (moderate cost of government)

According to Deloitte, Ukraine has a flat income tax rate of 13 percent. The top corporate tax rate is 25 percent. In 2003, according to the Economist Intelligence Unit, government expenditures as a share of GDP increased by 1.7 percentage points to 28.4 percent, compared to a 0.5 percentage point decrease in 2002. On net, Ukraine's fiscal burden of government score is 0.3 point worse this year.

GOVERNMENT INTERVENTION IN THE ECONOMY

Score: **2**–Better (low level)

The World Bank reports that the government consumed 15.8 percent of GDP in 2003, down from the 20.4 percent reported in the 2005 *Index*. As a result, Ukraine's government intervention score is 0.5 point better this year. In the same year, according to the International

Monetary Fund's Government Financial Statistics CD-ROM, Ukraine received 4.65 percent of its total revenues from state-owned enterprises and government ownership of property.

MONETARY POLICY

Score: **3**–Worse (moderate level of inflation)

From 1995 to 2004, Ukraine's weighted average annual rate of inflation was 7.86 percent, up from the 5.91 percent from 1994 to 2003 reported in the 2005 *Index*. As a result, Ukraine's monetary policy score is 1 point worse this year.

CAPITAL FLOWS AND FOREIGN INVESTMENT

Score: **4**–Stable (high barriers)

Ukraine officially guarantees equal treatment of foreign investment but restricts investment in certain "strategic" enterprises (radio, television, energy, and insurance). According to the U.S. Trade Representative, "An underdeveloped banking system, poor communications networks, a difficult and frequently changing tax and regulatory climate, crime and corruption, and a weak legal system create major obstacles" to investment. In addition, "the privatization process continues to lack transparency.... In the 2004 Presidential election year, the Ukrainian government rushed to privatize large plants including coal mines and steel mills. The privatizations were marked by unclear, non-transparent and changing regulations and by heavy political interference that practically excluded foreign investors from participating in privatization." The new government has said that it will review these privatizations and determine whether they need to be revoked and resold. The International Monetary Fund reports that resident and non-resident foreign exchange accounts are subject to restrictions and government approval in some cases. Payments and transfers are subject to various requirements and quantitative limits. Some capital transactions are subject to controls and licenses. According to the Economist Intelligence Unit, "Ukraine remains a difficult place to conduct business. Businesses are still exposed to pervasive corruption and an unwieldy and unreformed bureaucracy."

BANKING AND FINANCE

Score: **3**–Stable (moderate level of restrictions)

According to the Economist Intelligence Unit, "All parts of the sector—including banks, non-bank financial institutions and the securities market—are still largely underdeveloped and suffer from insufficient capital, an unsatisfactory legal infrastructure and limited investment opportunities." In 2004, reports First Initiative, "the banking sector was comprised of 182 commercial banks, including 20 foreign banks (7 of them with 100% foreign capital) and two state owned banks." The U.S. Department of Commerce notes that the "top ten banks control 55 percent of loans outstanding and own 36 percent of the total capital of the system." A January 2002 law "On Banks and Banking Activity" ended discrimination against foreign banks. According to the U.S. Trade Representative, "Foreign insurance firms and banks are permitted to operate in Ukraine, but they cannot open branches, a prohibition that impedes participation of foreign businesses in Ukraine. Nevertheless, investors can open 100 percent foreign-owned subsidiaries."

WAGES AND PRICES

Score: **3**–Stable (moderate level of intervention)

The government controls some prices. According to the U.S. Department of Commerce, "The cabinet of Ministers of Ukraine has price-setting authority with products, goods, and services in certain sectors. These lists include basic tariffs (e.g., electricity, telecommunications, transportation, utilities), and some crucial products such as sugar, grain, gas, oil, etc." In April 2005, the government set price caps on electricity in response to a 15 percent sudden price surge, but it removed the caps a few months later. Ukraine has a minimum wage.

PROPERTY RIGHTS

Score: **4**–Stable (low level of protection)

Protection of property is weak. The U.S. Department of State reports that Ukraine's "judiciary is subject to considerable political interference from the executive branch and also suffers from corruption and inefficiency." According to the U.S. Department of Commerce, "Organized crime is alleged to influence court decisions." The Economist Intelligence Unit reports that "the institutional capacity of the state and the judiciary is too weak to combat organised crime effectively. Organised crime and domestic vested interests pose a significant threat to foreign investors who become involved in those areas of the local economy that are considered to be protected." Expropriation is possible. In June 2005, according to the *Financial Times*, the government agreed "to hold a new auction for...the country's largest steel mill, after a court stripped away ownership from businessmen close to...the ousted former president."

REGULATION

Score: **4**–Stable (high level)

The U.S. Department of Commerce reports that "the number of regulations, required certificates, and inspection regimes in Ukraine impose a significant regulatory burden on private enterprise.... The [government] requires enterprises to obtain numerous permits to conduct business. Procedures are complex, unpredictable, burdensome, and duplicative creating confusion, increasing the cost and time to do business in Ukraine, providing opportunities for corruption, and driving business into the shadow economy.... 'One-stop Registration Shops' have been introduced in several cities [for] land use and other permits." According to the Economist Intelligence Unit, "Corruption among public-sector officials stems from the low level of wages and the high level of bureaucracy, which has resulted in pervasive bribery...."

INFORMAL MARKET

Score: **4**–Stable (high level of activity)

Transparency International's 2004 score for Ukraine is 2.2. Therefore, Ukraine's informal market score is 4 this year.

EXHIBIT 2

Report No. 32721-UA

Ukraine Jobs Study

Fostering Productivity and Job Creation

(In Two Volumes) Volume I: Overview

November 30, 2005

Human Development Sector Unit
Ukraine, Belarus and Moldova Country Unit
Europe and Central Asia Region

Document of the World Bank

CURRENCY EQUIVALENTS
(Exchange Rate Effective 08/032005)

Currency Unit = Hryvna (UAH)
5.0126 UAH = 1 USD
USD 0.20 = 1 UAH

FISCAL YEAR

January 1 - December 31

ABBREVIATIONS AND ACRONYMS

ALMP	Active Labor Market Programs
BEEPS	EBRD-World Bank Business Environment and Enterprise Performance Surveys
CEE	Central and Eastern Europe
CIS	Commonwealth of Independent States
CPI	Consumer Price Index
EBRD	European Bank for Reconstruction and Development
EPL	Employment Protection Legislation
EU	European Union
EU-8	New EU member states: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic, and Slovenia
FDI	Foreign Direct Investments
FSU	Former Soviet Union
GDP	Gross Domestic Product
ILO	International Labor Organization
IMF	International Monetary Fund
LFPR	Labor Force Participation Rate
LFS	Labor Force Survey
OECD	Organization for Economic Cooperation and Development
PPP	Purchasing Power Parity
SME	Small and Medium Enterprises
SOE	State-Owned Enterprises
ULMS	Ukrainian Longitudinal Monitoring Survey

Vice President:	Shigeo Katsu
Country Director:	Paul Bermingham
Sector Director:	Charles C. Griffin
Sector Manager	Arup Banerji
Task Team Leader:	Jan Rutkowski

Ukraine Jobs Study
Fostering Productivity and Job Creation

Table of Contents

List of Tables

List of Figures

List of Boxes

Volume II: Technical Chapters

PREFACE

The Ukraine Jobs Study was undertaken following the "Orange Revolution" of 2005. Among the main economic objectives of the new Government are the acceleration of structural reforms, improvement of the investment climate and the creation of new jobs. The main purpose of the study is to assist Ukrainian policymakers in their efforts to create more and better jobs. It also aims at informing the key stakeholders and wider public on policy reforms necessary to improve the workings of the labor market in Ukraine. The study primarily relies on statistical analysis of recent labor market developments in Ukraine using the Ukrainian Longitudinal Monitoring Survey. It also draws on extensive consultations and discussions with government officials, trade unions, employers' representatives and the research community.

The study builds on earlier work conducted by the World Bank on labor markets in Ukraine, including a *Risk and Vulnerability Study* (World Bank, 2003), a *Country Economic Memorandum* (World Bank, 2004), and the recent *Poverty Assessment* (World Bank, 2005).

This report was prepared by Jan Rutkowski (Task Team Leader, ECSHD) with the assistance of Christian Bodewig (ECSHD). It draws on a commissioned background paper by Hartmut Lehmann, Olga Kupets and Norberto Pignatti. Imelda Mueller edited the report.

The report comes in two volumes. This volume (Volume I) provides an overview of the study and summarizes its conclusions. Volume II provides more technical and detailed analysis of various aspects of labor market transition in Ukraine. Volume II is available upon request from the Task Team Leader (jrutkowski@worldbank.org).

An earlier version of this report was presented at a World Bank Seminar held in Kyiv on November 2, 2005. The study benefited from discussion following its presentation, and in particular from comments provided by Natailia I. Ivanivna (Deputy Minister of Labor and Social Policy), Grigoriy V. Osoviy (Deputy Chairman, Federation of Trade Unions of Ukraine), Vadym Pischeyko (Department Head, Ministry of Economy and European Integration), and Natalia S. Vlasenko (Deputy Head, State Committee for Statistics).

The team is grateful for the support and guidance of Paul Bermingham, Country Director (ECCU2) and Arup Banerji, Human Development Economics Sector Manager (ECSHD). The team benefited from comments of peer reviewers Wendy Cunningham (LCSHS) and Philip O'Keefe (SASHD). Useful suggestions were provided by Gordon Betcherman, Gerardo Corrochano, Mark Davis, Arvo Kuddo, Zafiris Tzannatos and Dusan Vujovic. The team would also like to thank the Ministry of Economy and European Integration, the Ministry of Labor and Social Policy, and the State Committee for Statistics for their collaboration.

EXECUTIVE SUMMARY

The objective of this study is to assist policymakers in Ukraine in their efforts to create more and better jobs in Ukraine by (i) providing an assessment of labor market performance in Ukraine; (ii) identifying key constraints to job creation; and (iii) suggesting policies that will foster job creation and productivity. The study finds that, despite relatively low unemployment, labor market in Ukraine is depressed and productive job opportunities are scarce. Moreover, unemployment is likely to increase once enterprise restructuring accelerates. The primary cause of poor labor market outcomes in Ukraine is the small size of the "new" private sector, consisting of *de novo* private, usually small firms. This, in turn, is due to the poor investment climate brought about by high risks, costs and barriers associated with dong business in Ukraine. Accordingly, the key to improving labor market outcomes is to remove main impediments to entry of and growth by firms, such as policy uncertainty, corruption, red tape, inefficient regulations and poor access to finance. In the longer term, labor market institutions need to be reformed to create an adaptable labor market and thus support job creation and productivity growth.

I. DOES THE LABOR MARKET IN UKRAINE PERFORM WELL?

The labor market in Ukraine is at a relatively early stage of the transition. Most labor is still employed in the public sector, which implies that the major wave of job and labor reallocation, with an attendant increase in unemployment, lies in the future. At the same time, despite low open unemployment the labor market is depressed and productive job opportunities are few. Labor force participation is low due to the " discouraged worker effect": workers cease looking for work as they no longer believe that jobs are available. Labor market dynamics is limited, as evidenced by low labor and job flows. However, job and labor reallocation needs to be intensified in order to improve economic efficiency, support productivity and, consequently, wage growth. In addition, the wage structure needs to become more flexible to better align wages with productivity differentials and thus support the process of reallocation of labor resources toward their most productive uses. The room to improve the utilization of labor resources is considerable.

Labor is underutilized in Ukraine despite relatively low unemployment. The unemployment rate, at about 8 percent, is relatively low by the standards of transition economics. But the unemployment rate does not tell the whole story. The scarcity of job opportunities in Ukraine manifests itself largely in the low labor force participation rate. Many workers have become discouraged by the futility of their job search and have withdrawn from the labor force. Only about 60 percent of the working age population are either employed or looking for a job. As a result the employment-to-population ratio, which is the most comprehensive indicator of the degree of utilization of labor resources, is low in Ukraine. Less than 60 percent of the working age population is employed, which is both below the OECD average of 65 percent and less than in most successful transition economies.

Low open unemployment may indicate delayed and slow enterprise restructuring. The public sector is still large in Ukraine and many state-owned enterprises (SOEs) are overstaffed, which leads to low labor productivity. Overstaffing is unsustainable in a competitive environment. Once the SOEs become exposed to domestic and international competition, they are forced to shed redundant labor in order to be competitive. This will result, at least temporarily, in an increase in unemployment. Such

an increase in unemployment in the wake of accelerated enterprise restructuring is experienced by virtually all transition economies.

Until recently, employment was stagnant despite high rates of economic growth. This phenomenon, known as "jobless growth", is quite common among transition economies and is not specific to Ukraine. One explanation for this phenomenon is so called "defensive restructuring" by enterprises. This means that many Ukrainian firms improve productivity largely by shedding redundant labor. Productivity gains are then translated into higher wages rather than higher employment. Defensive restructuring is partly the consequence of labor hoarding inherited from the system of central planning. But it also means that firms will find it costly to hire additional labor.

A recent upsurge in job growth is due mainly to the expansion of the informal sector. After the period of jobless growth, employment started to increase in 2002. However, most new jobs – nearly 60 percent – have been created in the informal sector. The hiring rate in the informal sector is roughly five times higher than in the formal sector, while the separation rate in the informal sector is only twice as high as in the formal sector. The growth in the informal sector is a typical response to onerous regulations and high taxation and is indicative of an inhospitable business environment.

The growth in informal sector employment has both positive and negative aspects. On one hand, the informal sector provides jobs and is a source of income, helping many workers to escape poverty. For example, one-third of the jobless escape unemployment by finding jobs in the informal sector. On the other hand, workers employed in the informal sector enjoy little employment security and are deprived of benefits (e.g. pensions) financed by payroll taxes. An immediate cost to the society is the narrowing of the tax base, which leads to higher tax rates paid by formal sector firms, fuelling informality and distorting competition. Moreover, informal sector firms tend to remain sub-optimally small, which results in distorted and insufficient economic growth.

Informal sector offers better earning opportunities. Workers in the informal sector enjoy a wage premium of 10 to 15 percent compared with similar workers in the formal sector. This implies that workers are not only pushed into the informal sector by lack of job opportunities but also pulled into it by better earning prospects. However, it is uncertain whether these higher earnings compensate for the absence of various employment related benefits, which are offered by the formal sector.

Informal sector employment tends to be of low productivity. Young, poorly educated and unskilled blue-collar workers are disproportionately represented among the informal sector workers. For example, unskilled workers account for one-third of informal sector employment compared with less than one-fifth of formal sector employment. In addition, informal jobs are concentrated in industries where productivity is relatively low (trade, agriculture, construction). Majority (close to 80 percent) of the informal sector workers are either self employed, or employed in micro firms.

The unemployed have few opportunities of finding jobs, which results in long periods of unemployment and a high incidence of long-term unemployment. One unemployed worker in two is jobless for longer than one year. By way of comparison, in the United States which epitomizes a dynamic labor market, the incidence of long term unemployment is less than 10 percent. A high incidence of long-term unemployment in Ukraine is thus a symptom of a stagnant labor market. It is also socially costly, as long term unemployment leads to an erosion of skills and a fall in morale which further reduces employment opportunities.

Enterprise restructuring has led to a more efficient use of labor in Ukraine. The type of jobs that are being created are more productive than those that are being destroyed. Labor is thus moving to more productive uses, which improves allocative efficiency and gives rise to earnings gains.

But job reallocation proceeds at a relatively slow pace in Ukraine. Both the job creation rate and the job destruction rate seem to be lower in Ukraine than in the dynamic transition economies, such

as Lithuania or Poland. This implies that there is still substantial room for improvement in allocative efficiency in Ukraine; that is, for labor moving to its most productive uses.

Jobs have moved from industry to services, and the services sector has become a major source of employment. Deindustrialization is typical of virtually all transition economies, as industry was overdeveloped under central planning while services were underdeveloped. The employment structure dominated by services, which has evolved in Ukraine during the transition, is characteristic of developing countries with GDP per capita similar to that of Ukraine. However, widespread informality in the services sector means that the challenge to develop a truly modern, productive services sector in Ukraine still lies in the future.

Wage flexibility is limited which might inhibit labor market adjustment. Wages still are determined in a rather centralized way, especially in public and privatized firms. Trade unions play an important role in wage determination and contribute to wage pressures. It is important to note that wage adjustment is critical for attaining labor market equilibrium; however, resulting wage rigidities might contribute to labor market imbalances, particularly to unemployment. Factors pointing to limited wage flexibility include significant wage growth despite unemployment, relatively high minimum wage and modest returns to education.

Wages grew in excess of productivity in recent years, raising unit labor cost. Real wages have grown at an impressive rate of 19 percent per year since 2000, faster than GDP per worker (which is a proxy for productivity). Such a fast growth in real wages reflects insider power in wage determination. However, the resulting increase in unit labor cost dampened labor demand and was one source of jobless growth. Thus, the increase in labor demand associated with output growth benefited the employed insiders rather than the unemployed outsiders.

Relatively high minimum wage may have negative employment effects but lax enforcement limits its "bite". The statutory minimum wage hovers around 40 percent of the average wage in Ukraine. This is high by standards of Central and Eastern Europe (CEE) economies, where in most countries the minimum wage is less than 35 percent of the average wage.[1] Evidence presented in this report shows that a significant fraction of workers earn less than the minimum wage, suggesting that the minimum wage regulation is not enforced. If enforced, however, the minimum wage could have a substantial detrimental effect on unskilled worker employment. Many workers who currently earn less than the minimum wage would lose their jobs because employers would not want to keep workers whose productivity is lower than the wage they are to be paid.

Returns to education have been low in Ukraine. Only very recently (in 2004), wage premia to education increased to levels close to that in other transition economies of CEE. This much delayed increase in returns to education in Ukraine indicates that either the wage structure has adjusted slowly to the changes in demand for skills, or the increase in demand for high skills has been more limited in Ukraine than in other transition economies. The latter reason would be consistent with the slower opening of the Ukrainian economy and a slower pace of technological progress (which is biased towards skilled labor). The modest returns to education are yet another sign that the Ukrainian labor market is at a relatively early stage of transition.

Wage distribution has decompressed during the transition in Ukraine, as it has in other transition economies. However, the actual degree of wage inequality is unclear; estimates range from moderate to high, depending on the data source.[2] It is also not clear whether the increase in wage

---

[1] The minimum wage in Ukraine is high in *relative* terms, not in *absolute* terms. While the absolute value of the minimum wage determines workers' consumption level, the relative value (in relation to the average wage) determines its labor market effects: the impact on employment and the wage distribution.

[2] It should be noted that *wage* inequality is only one factor affecting *income* inequality. An important factor contributing to income inequality is non-wage income, e.g. income from entrepreneurial activity.

dispersion is associated with greater economic efficiency. For this to be the case, wage differentials would need to reflect productivity differentials among workers. But this is not necessarily the case. Wage differentials may well reflect various rents (e.g. monopoly rent) which proliferate in a non-competitive environment. Available evidence suggests that such rents indeed do exist in the Ukrainian economy and are partly captured by workers, especially in the unionized sector. But further research is necessary to determine the efficiency of the wage structure in Ukraine.

Trade unions play an important role in shaping industrial relations in Ukraine. The unionization rate is high and so is the union bargaining coverage. At the same time, employers representing the new private sector are only beginning to organize themselves and articulate their interests. In the *formal* sector the unionization rate reaches 70 percent and the union bargaining coverage is still higher at close to 90 percent. These rates are very high by the standards of other transition economies and those of OECD (where on average union density is 20 percent, and bargaining coverage is 35 percent). In virtually all CEE countries, the unionization and bargaining coverage rates have declined sharply along with the growth of the private sector and a move toward decentralized bargaining structures (i.e. from industry to firm level bargaining). The weakness of the employers' representation is reflected in the fact that a majority of industry level collective agreements are signed *not* with the representatives of private business, but instead with line ministries which represent the State as the main employer.

High union density and bargaining coverage reflect a slow development of the new private sector. Expectedly, the trade union stronghold is large in public as well as privatized enterprises. For example, the union density rate is some 80 percent in the public sector and less than 10 percent in the new private sector.

II. WHAT ARE THE KEY CONSTRAINTS TO JOB CREATION IN UKRAINE?

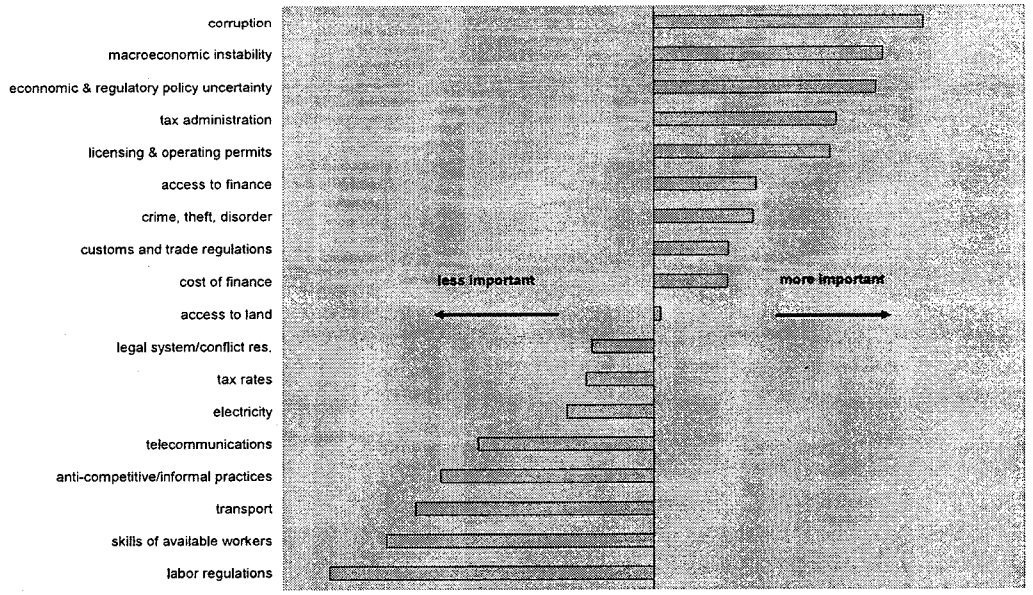
The primary cause of poor labor market outcomes in Ukraine is unfinished structural reforms and an inhospitable investment climate. Policy uncertainty, corruption, bureaucratic harassment, red tape and inefficient regulations inhibit entry of and growth by firms. As a result, the size of the new private sector is small, which in turn limits job creation. Labor market institutions are rigid and ill-suited to the needs of an economy which needs to restructure and grow. However, lax enforcement provides for de facto labor market flexibility. Firms do not comply with labor regulations and often hire labor informally. Thus, labor market institutions do not seem to be a significant barrier to job creation because regulations are evaded.

The major labor market problem in Ukraine is the low employment level, which reflects the scarcity of jobs. Why are there too few jobs in Ukraine? In Ukraine, as in all other transition economies, jobs are created mainly by the private, usually small, firms. However, the size of this job-generating sector in Ukraine is significantly smaller (less than 30 percent of total employment) than in the most successful transition economies. The high costs of doing business in Ukraine deter entry of new firms and growth and profitability of existing ones. Hence, there are too few jobs because there are too few firms. Evidence indicates that the investment climate in Ukraine has indeed been poor, significantly worse than in most CEE countries, and is considered the ultimate cause of the slow pace of job creation.

Poor governance, uncertainty, administrative barriers and poor access to finance are the areas where the Ukrainian economy performs particularly poorly. Figure 1 uses entrepreneurs' perceptions as basis for identifying major obstacles to business operation. It highlights those obstacles which are more severe in Ukraine than in EU-8 countries. The figure makes it clear that Ukraine faces a formidable challenge to reduce corruption, lessen regulatory and economic policy uncertainty, and to remove administrative barriers that constrain business activity. Poor access to finance also limits investment and job creation.

High tax rates are viewed as one of the most important constraints. Some 40 percent of entrepreneurs in Ukraine see high tax rates as a major obstacle to the operation and growth of their firms.[3] In particular, payroll taxes are blamed for raising the labor cost and limiting hiring. However, these results need to be put into perspective. There is no doubt that taxes on business limit economic activity, and taxes on labor are likely to discourage hiring. At the same time, taxes pay for important public services and social benefits and, as such, are part of all modern economic systems. In fact, taxes are seen as less of a constraint in Ukraine than in other CEE countries (Figure I). It must also be noted that payroll taxes are lower in Ukraine than in most CEE countries. Thus, taxes do add to labor costs in Ukraine, but not as much as they do in other countries. The problem is thus not taxes per se, but inefficiencies in the public, including social, expenditure system).

Figure I: Corruption, uncertainty, administrative barriers and poor access to finance are seen by employers as major obstacles to firm operation and growth



Note: the chart shows deviations from the EU-8 and factor average scores.
Source: EBRD-World Bank Business Environment and Enterprise Performance Survey, 2002.

Labor regulations are not seen by entrepreneurs as a major constraint. In fact, as Figure I shows, they are viewed as the least significant obstacle to firms' operation and growth, considerably less important than in other CEE countries.

But on paper, employment protection legislation is extremely stringent in Ukraine. According to the *World Bank Doing Business* indicators, employment protection legislation in Ukraine is significantly stricter than in other CEE countries and much stricter than in most OECD countries. Employment relations are overregulated and firing costs are extremely high.

The draft labor code relaxes some of the constraints on labor adjustment but still over-regulates employment relations. The draft labor code (as of Spring 2005) bears the legacy of

[3] High tax rates rank as the third most significant obstacle to firm operation and growth in Ukraine (after macroeconomic instability and regulatory and policy uncertainty). However, taxes are perceived as less of an obstacle in Ukraine than in most EU-8 countries, and that is why they are show as less important in Figure I, which shows *relative,* rather than *absolute,* importance of various obstacles.

communist labor relations. It provides detailed regulations of almost every possible aspect of industrial relations and provides for high procedural costs of labor adjustment. For example, employers would need to notify the relevant trade union of a planned lay-off at least three months prior to its occurrence, discuss with the union possible preventive measures, and carry out the lay-off only in accordance with the trade union's opinion. At the same time the use of fixed-term contracts, which can facilitate labor adjustment, is strictly limited. As such, the draft labor code does not provide regulatory foundations for an adaptable labor market. One additional shortcoming of overregulated labor relations is that they impede the development of social dialogue and collective bargaining. If all aspects of labor relations are already regulated by the labor code and the statutory minima are set at a high level, then there is little scope for direct bargaining between employers and trade unions.

The discrepancy between employers' perceptions and objective indicators of the strictness of employment protection legislation is explained by lax enforcement of labor regulation. **But labor market flexibility through non enforcement is not an optimal outcome.** It undermines the rule of law, exposes firms to costly uncertainty (circumventing regulations involves costs, especially if enforcement is discretionary and selective) and leaves workers without adequate protection. Unduly strict employment protection legislation, even if only weakly enforced, is not conducive to fast and large scale reallocation of labor, which is necessary for successful transition and productivity growth.

Unemployment benefit system was not found to be a factor behind unemployment in Ukraine. There is no evidence that the receipt of unemployment benefit negatively affects job search duration. This is due to the modest generosity of the system: only 40 percent of the unemployed receive benefits and the replacement rate (26 percent of the average wage) is relatively low.

Skill mismatch does not seem to contribute significantly to unemployment in Ukraine. One reason is that there is still considerable demand for low-skilled labor. This is in sharp contrast to other transition economies of CEE where market oriented reforms brought about a marked fall in demand for less skilled manual labor. This is yet another indication that the labor market in Ukraine is at a relatively early stage of transition. Most likely, Ukraine will experience a similar evolution of labor demand away from less skilled manual labor as did other transition economies, which will result in an increase in unemployment among this worker group.

III. How to Create More and Better Jobs in Ukraine?

In order to create more and better jobs, Ukraine needs to pursue a two pronged strategy. First and foremost, it needs to improve the investment climate and lower the cost of doing business to encourage entry of and growth by firms. There is a need to provide adequate incentives for firms to be established and grow, in order to expand for job creation as well as accelerate absorption of workers displaced by structural changes. "Encouragement" policies such as these are particularly important given that the size of the "new" job generating sector is still small in Ukraine. Second, it needs to reform its labor market institutions to create an adaptable labor market, that is, a market where employers have incentives to hire workers, and workers have incentives and skills to take-up available jobs.

While improving the investment climate is the immediate priority, in the mid-term labor market reforms are necessary to lay an institutional foundation for the competitiveness of Ukrainian firms and for job creation. Strict but loosely enforced labor regulations should be replaced by regulations that are more flexible but effectively enforced, so as to protect core worker rights. At the same time, a greater role in setting standards of employment protection should be given to direct bargaining between genuine representation of business and workers.

Labor market reforms should constitute a package consisting of three major elements: (a) the liberalization of employment relations, (b) the development of direct bargaining between

employers and workers, and (c) effective enforcement of core worker rights. In particular the following options should be considered:

- *Liberalizing employment protection legislation.* The labor code should regulate a narrower area of employment relations and the regulations should provide for minimum statutory standards of employment protection so as to create room for direct bargaining between social partners. In particular, the *procedural* costs of dismissals should be reduced to facilitate employment adjustment. Provisions governing flexible employment contracts (e.g. fixed term contracts) should be liberalized so as to lower labor adjustment cost and encourage hiring. Working time flexibility should be enhanced by liberalizing rules governing overtime work, and permitting the redistribution of the working hours limit over a longer period of time to facilitate adjustment to seasonal demand fluctuations.

- *Developing efficient bargaining structures.* The collective bargaining system in Ukraine needs to develop so as to meet the criteria for efficiency. Particularly, the interests of employers need to be better balanced with those of employees. Collective agreements concluded with the state acting as an employer will need to be renegotiated to be applied to the private sector. Moreover, the efficiency of industry level bargaining needs to be reassessed. Industry level bargaining can be inefficient since the agreements take into account neither firm specific conditions, nor economy-wide effects of wage increases. Therefore, such agreements should include opt-out options for firms which cannot afford to comply. An alternative is to move away from industry level bargaining toward more efficient firm level bargaining. Firm level bargaining takes into account firm specific conditions as well as the effects of the agreement on the firm's competitiveness. However, a move toward firm level bargaining assumes that worker interests are adequately represented at the firm level.

- *Improving the enforcement capacity of labor inspections.* While the employment protection legislation should be significantly liberalized and employment relations should be deregulated, the core worker rights should be effectively protected. Firms need to comply with labor regulations to respect the rule of law, and to provide workers with socially acceptable and economically efficient degree of employment protection. But rather than increasing the already high burden of inspections on firms, or increasing the penalties, new modes of inspection services, such as self-reporting or contracting-out, should be tested.

- *Reviewing the minimum wage policy so as to take into account labor market conditions and unemployment among affected workers.* Currently, the minimum wage is high *relative* to the average wage, but not enforced.[4] Enforcement, however, could cause job loss among less productive workers (youth, unskilled workers). Therefore, the government can consider setting minimum wage at a lower proportion of the average wage (e.g. one-third of the average wage) to limit its potential dis-employment effect. This can be coupled with setting a separate minimum base for social insurance contribution to protect social budget revenues. Alternatively, a youth sub-minimum (e.g. 80 percent of the regular minimum) could be instituted to protect employment among the most vulnerable group. In addition, social benefits should be delinked from the minimum wage to render the minimum wage policy independent of other social policies.

- *Reducing payroll taxes.* This involves broadening the tax base through providing incentives for firms to move to the formal sector, and improving the cost-effectiveness of social expenditures

[4] This assessment is based on the assumption that official estimates of the average are correct. If however, as sometimes asserted, wages are significantly underreported then the minimum wage to average wage ratio is overestimated and accordingly the "bite" of the minimum wage is less. Therefore it is important that the minimum wage policy is based on reliable data on the wage distribution.

which are financed by payroll-taxes (mainly pensions). This is a gradual process closely associated with reforming the social insurance system.

- *Putting in place the system of monitoring and evaluation of active labor market programs (ALMP).* ALMP can be a useful tool for improving employment chances of disadvantaged worker groups. However, they do not increase overall employment. Evidence shows that their *net* impact is limited. At the same time, they are costly. Therefore, it is important to improve the cost-effectiveness and targeting efficiency of the programs. To this end, net impact and cost per placement need to be determined for various client groups and under different labor market conditions so as to target programs at groups that benefit most from a given intervention.

FOSTERING PRODUCTIVITY AND JOB CREATION

This report provides an overview of the Ukraine Jobs Study and the summary of its main conclusions. Its purpose is to help policy makers and other stakeholders understand the functioning of the Ukrainian labor market, and to set the agenda for labor market reforms. The report focuses on three issues. First, it analyzes labor market structure and dynamics in Ukraine. Second, it examines factors that impede job creation and reduction in unemployment. Finally, it identifies key policy priorities and sets directions for reforms. The report claims that the Ukrainian labor market is at a relatively early stage of transition and the major restructuring effort still lies ahead. The size of the new sector, consisting of de novo *private firms, is relatively small, effectively limiting job creation and contributing to low labor market dynamics. Job creation is concentrated in the growing informal sector, while employment in the formal sector is low and stagnant despite fast economic growth. This points to the poor investment climate as a main factor constraining entry of and growth by firms and thus job creation. In fact, employers see poor governance, high uncertainty and numerous administrative barriers as major obstacles to operation and growth of their firms. Labor regulations are strict but not enforced. This limits their "bite". However, labor market flexibility through non-enforcement is not an optimal outcome. The report recommends that in order to improve labor market outcomes, the government should adopt a two-pronged strategy. First and foremost, it needs to improve the investment climate so as to encourage formal sector firm creation and growth. Second, it needs to liberalize the labor market which should be accompanied by better enforcement of core worker rights and with greater role being assigned to direct bargaining between employers and trade unions.*

The Ukrainian economy grows at a high rate and unemployment is relatively low. At the same time productive job opportunities are scarce, especially in the formal sector. Many workers have a hard time finding a job, and many become discouraged and withdraw from the labor force. Low unemployment masks a depressed labor market.

This report provides an assessment of labor market performance in Ukraine from an efficiency viewpoint.[5] First, it analyzes labor market structure to see how advanced labor market transition in Ukraine is. Second, it examines determinants of labor market performance to identify factors inhibiting job creation and productivity growth. Finally, it discusses policy options to improve labor market performance.

The report finds that the Ukrainian labor market is at a relatively early stage of transition and that the major restructuring effort is still ahead (see Box 1).[6] The size of the "new" sector, consisting of *de novo* private, usually small, firms is relatively small, substantially less than in more advanced transition economies of CEE. The economy is still dominated by the public sector with non-competitive wage setting. One surprising result is that labor demand is skewed toward less-skilled manual labor, which is in sharp contrast to other transition economies and indicates an early stage of enterprise restructuring. Labor market institutions are rigid and bear the legacy of communist labor relations. However, labor regulations are not enforced and thus have little "bite". The main constraint to job creation is unfavorable investment

[5] The recent Poverty Assessment looks at labor market policies and outcomes in Ukraine from a point of view of equity, i.e. examines their impact on income distribution and poverty (World Bank, 2005).

[6] This assessment refers to the evolution of labor market outcomes, not that of labor market policies and institutions. In particular, the criterion for delimiting the stages of labor market transition is the size of the old, unrestructured sector, where many jobs are of low productivity and not viable in a competitive environment.

climate (in particular poor governance and numerous administrative barriers) which limits entry and growth of firms. For example, 20 percent of firms in Ukraine complain about custom and trade regulations, or about licensing and operating permits. In the Baltic states only 10 percent see these as major obstacles. Accordingly, the major means of fostering job creation is to lower the cost of doing business in Ukraine. At the same time, Ukraine should reform its labor market institutions to support an adaptable labor market. The three main components of the labor market reform package are: (a) liberalization and deregulation of employment relations, (b) better enforcement of key worker rights, and (c) the development of decentralized bargaining structures.

This Volume – main report – provides an overview of the report and summarizes its main conclusions. Volume II contains technical chapters. Chapter 1 presents major trends and patterns of labor market transition in Ukraine. Chapter 2 focuses on labor flows, and Chapter 3 looks at job reallocation. Chapter 4 considers the fate of displaced workers, and Chapter 5 analyses wage determination. Finally, Chapter 6 examines investment climate conditions and labor market institutions and policies in Ukraine.

Box 1. The Stages of Labor Market Transition

This box presents a simple model of labor market transition. The model distinguishes between four stages of labor market transition:

First (initial) stage: the dominance of job destruction. The old sector (consisting of state owned enterprises) is large, the new sector (consisting of de novo private firms) is small; job creation (largely in the new sector) falls short of job destruction (largely in the old sector), employment falls and unemployment raises.

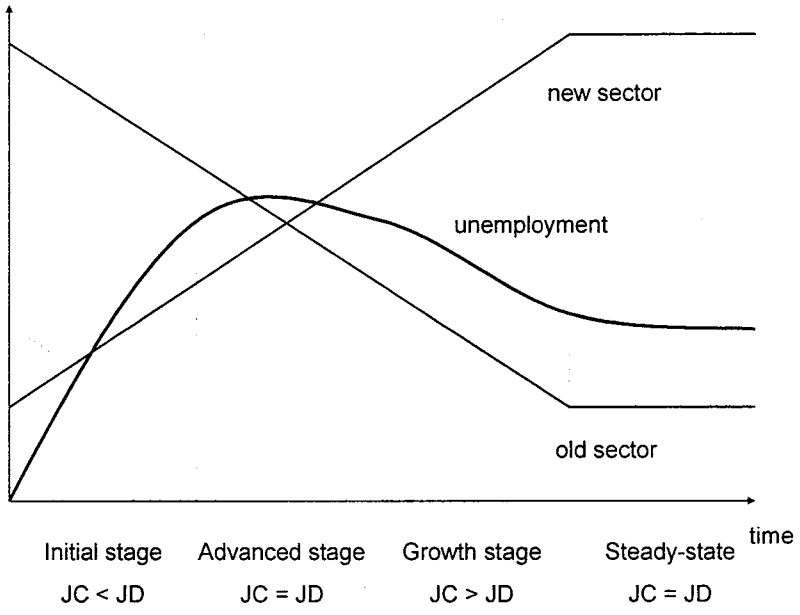
Second (advanced) stage: balanced (synchronized) job flows. The old sector become relatively small and the new sector become relatively large, the rate of job creation catches up with the rate of job destruction, employment stabilizes, but accumulated non-employment does not fall.

Third (growth) stage: the dominance of job creation. The new sector accounts for most of the economy, job creation exceeds job destruction, employment grows and non-employment falls.

Fourth (stability) stage: the steady state. The rate of job creation on average equals that of job destruction. Employment and unemployment cyclically oscillate around the steady state (equilibrium) level.

The model posits that the evolution of employment outcomes during the transition is hump-shaped. For example, low unemployment may indicate either the "initial" stage when enterprise restructuring is at an early phase, or the "growth" stage when the new sector creates jobs on a net basis and absorbs labor released from the old sector. The path of labor market transition is schematically depicted in Figure A.

Figure A The path of labor market transition

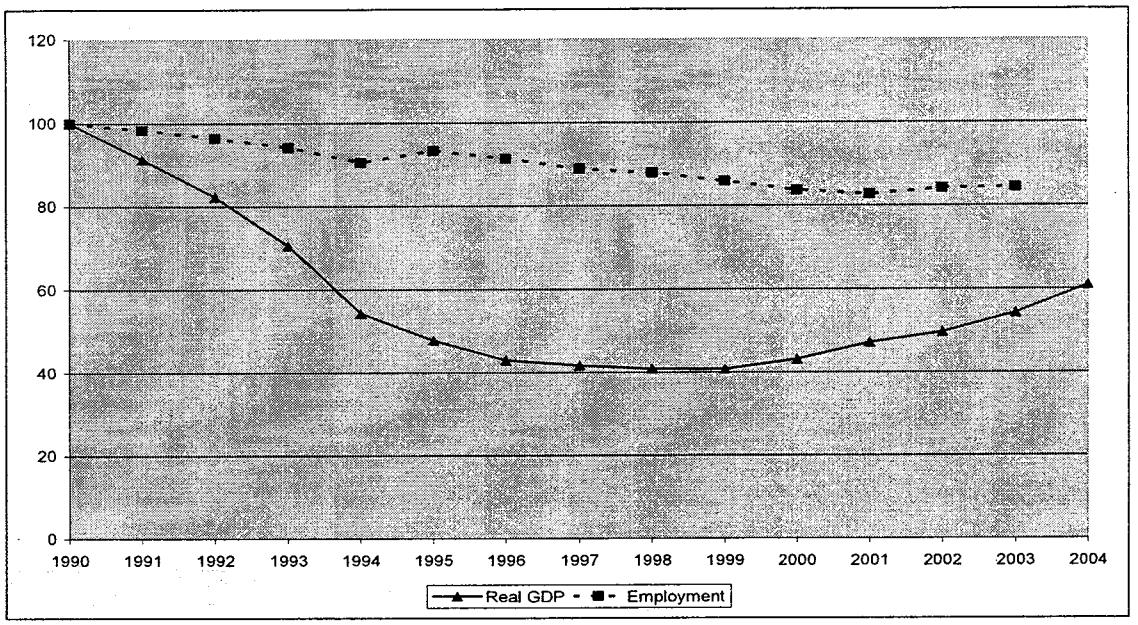


Note: JC stands for the job creation rate, and JD for the job destruction rate. The "unemployment" category covers unemployed and discouraged workers.

I. OPEN UNEMPLOYMENT IS LOW BUT LABOR IS UNDERUTILIZED[7]

The Ukrainian economy has been growing since 2000 at a very high rate of over 8 percent per year. **However, despite substantial output growth, employment growth until recently was negligible** (Figure 1). Such jobless growth is not specific to Ukraine. In fact, it has been experienced by most of the transition economies of CEE. Low elasticity of employment with respect to output is explained by the so called "defensive restructuring" by enterprises. As with other firms in the region, Ukrainian firms improve productivity by eliminating overstaffing and firing redundant labor. They can also easily increase output by improving the utilization of existing factors of production, that is, without firing new workers. The productivity gains are then translated into higher wages (Figure 2). In fact in the recent period a one percent growth in value-added per worker has led to roughly a one percent growth in real wages and to virtually no growth in employment. Thus, enterprise restructuring has benefited the "insiders" (i.e. workers who keep their jobs), at the cost of the "outsiders" (i.e., workers looking for a job). Apparently, few firms have been engaged in "strategic restructuring" where firms use productivity gains to increase production and, consequently, employment.

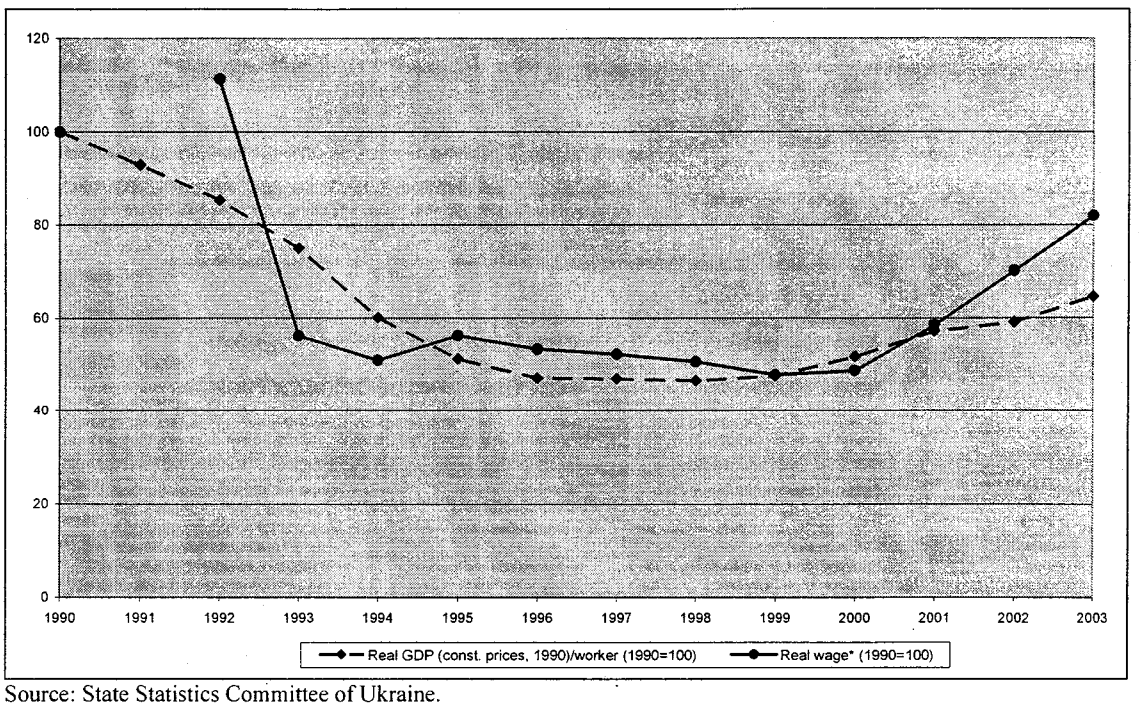
Figure 1: Employment is stagnant despite strong GDP growth
Real GDP, Employment (1990=100)



Source: State Statistics Committee of Ukraine.

[7] The empirical analysis presented in this section of the report draws on Lehmann and others (2005).

Figure 2: Productivity improvements lead to higher wages
Real GDP per Worker and Real Wage (1990=100)

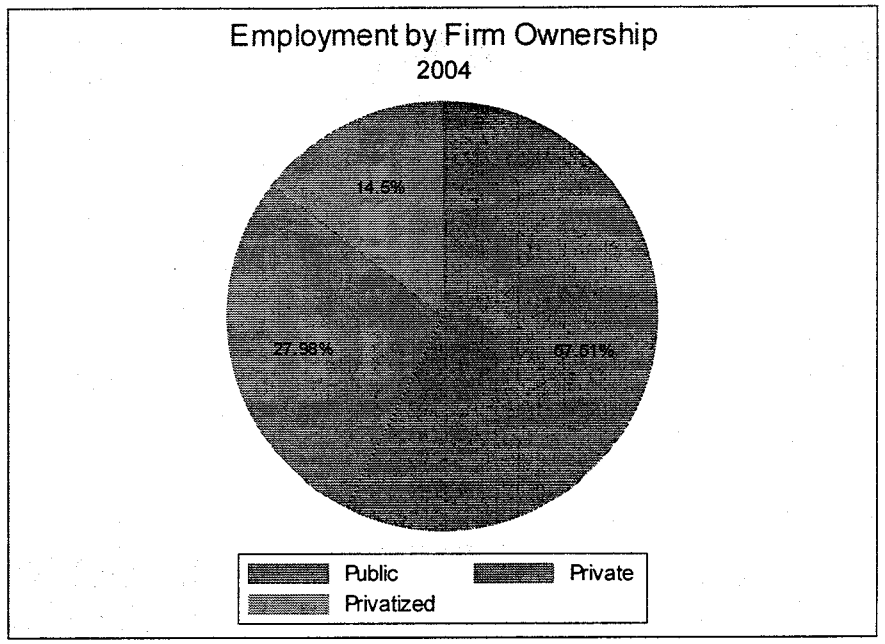


Source: State Statistics Committee of Ukraine.

One reason for the predominance of defensive restructuring by firms is the structure of Ukrainian economy, which is still dominated by large state-owned or privatized enterprises. The size of the "new" sector of the economy, consisting of *de novo* private, usually small, enterprises is relatively small, substantially less than in more advanced transition economies (Figure 3). In Ukraine, the public sector still represents close to 60 percent of total employment. *De novo* private firms account for less than 30 percent of employment (the rest is accounted for by privatized firms). [8] By way of comparison, in Poland, the public sector's share of total employment is only 30 percent. The experience of other transition economies shows that the economy's job creation potential is positively correlated with the size of the new sector: the larger the new sector, the higher the job creation rate. Thus, slow employment growth in Ukraine is in part due to the small size of the new sector.

[8] According to the official Derzhkomstat data, the private sector represented 47 percent of total employment in 2004. However, the private sector includes privatized firms, whose market behavior is often similar to that of state owned firms, and different from that of genuinely (de novo) private firms. For example the job creation rate in genuinely private firms is substantially higher than in the privatized firms (see below). For this reason this study focuses on the "new" private sector.

Figure 3: New private sector is still small in Ukraine



Source: Ukrainian Longitudinal Monitoring Survey, 2004

Although labor productivity has been growing, it is still low by regional standards.[9] The value-added per worker in Ukraine is substantially lower than in other European transition economies. Using GDP per capita (at purchasing power parity) as a rough proxy for productivity, one can see that labor productivity in Ukraine is one-third that in the Czech Republic, less than a half that in Poland and three-quarters that in Romania (Table 1). A similar picture emerges when one compares wages, which are much lower in Ukraine than in the neighboring CEE countries. Thus, the Ukrainian economy needs to converge to these higher productivity levels on its way to EU integration. This requires market friendly institutions and policies as well as investment, restructuring and competition. An efficient labor market is essential for achieving these objectives.

[9] Table A1.1 (Annex) provides comparative data on enterprise restructuring in Ukraine and its neighbors: Poland, Romania, Russia and Slovakia.

Table 1: Selected indicators of productivity and competitiveness: Ukraine against CEE Countries

Economy	GDP per capita; 2003 (at PPP)	Average wage, whole economy (2002)	Average wage, manufacturing (2002)	EBRD index of the progress of transition (2001)
	Ukraine = 100			
Bulgaria	143	185	142	3.038
Croatia	204	966	736	3.150
Czech R.	301	686	549	3.575
Estonia	244	524	428	3.538
Hungary	266	671	535	3.738
Latvia	182	369	284	3.150
Lithuania	206	391	323	3.325
Poland	212	728	566	3.563
Romania	132	228	169	2.913
Russia	168	..	..	2.625
Slovakia	246	422	369	3.400
Slovenia	353	1388	986	3.288
Ukraine	100	100	100	2.575

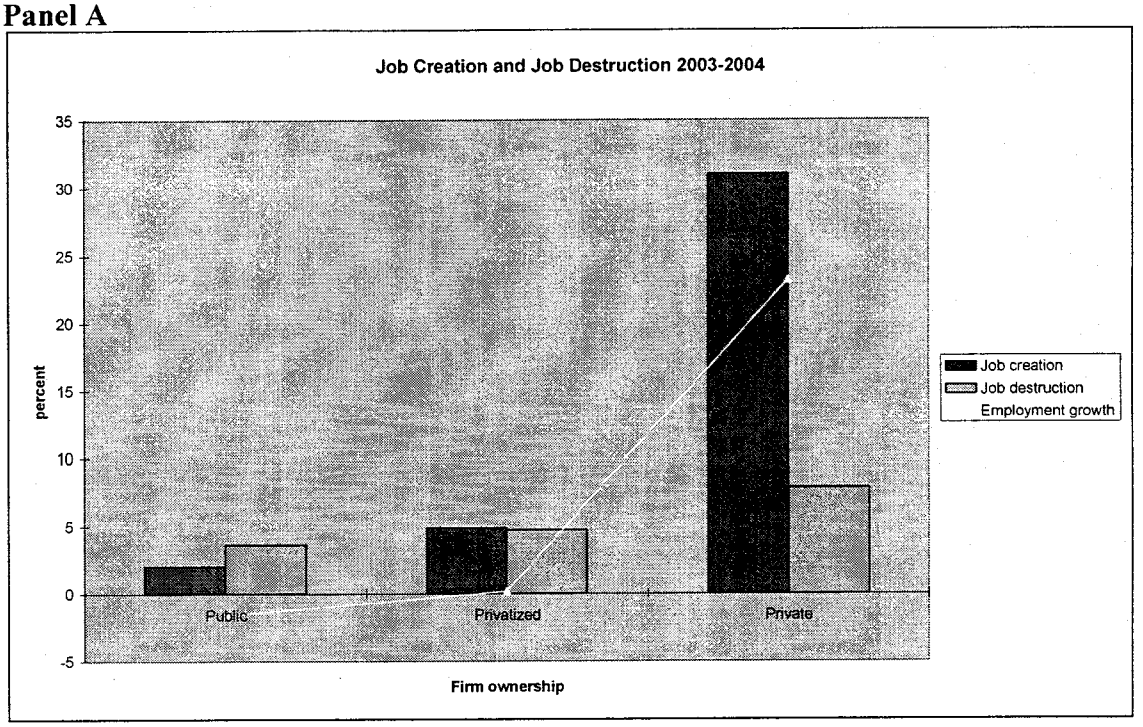
Source: World Development Indicators (2004), ILO Laborsta database, EBRD.

A recent upsurge in job growth is due mainly to the expansion of the informal sector. After the period of jobless growth employment started to increase in 2002. However, the strong job growth in the recent period has been largely driven by the expansion of the informal sector, which created nearly 60 percent of all new jobs between 2003 and 2004. During the same period, the hiring rate in the informal sector was roughly five times higher than in the formal sector, while the separation rate in the informal sector is only twice as high as in the formal sector. Thus, employment in the informal sector has significantly expanded in recent years, while that in the formal sector has roughly stagnated.

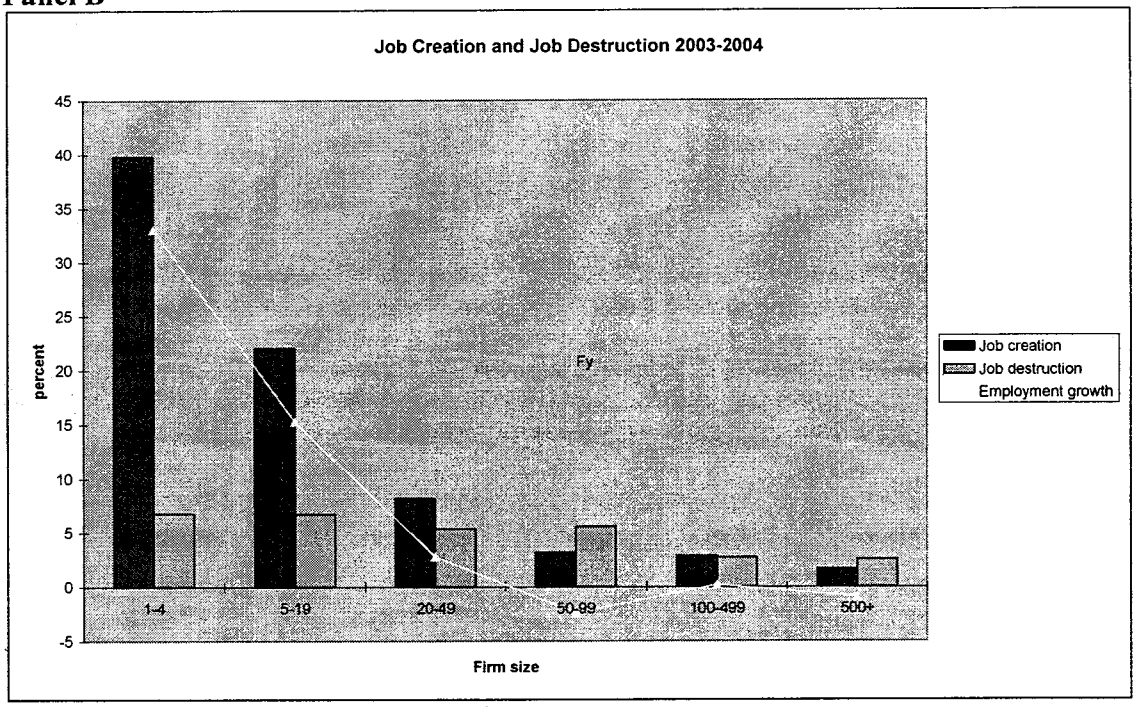
As in other transition economies, job growth in Ukraine takes place largely in small *de novo* private firms in the services sector. In contrast, large state-owned and privatized firms are predominantly downsizing. For example, while in new private firms (including informal ones) employment grew some 20 percent between 2003 and 2004, it fell by about 2 percent in the state owned firms (Figure 4, panel A). Similarly, net job creation falls notably with firm size (Figure 4, panel B). Notably, 40 percent of all newly created jobs were created in the services sector during the 2003-2004 period. However this positive dynamics taking place in small private firms does not translate into a large number of "good" (high-productivity) jobs. First, as it is shown below, the size of the job-generating sector is relatively small in Ukraine. Second, majority of new jobs are created in the informal sector where productivity tends to be lower and jobs are precarious.

Figure 4: Private and small firms are the primary source of new jobs

Panel A



Panel B

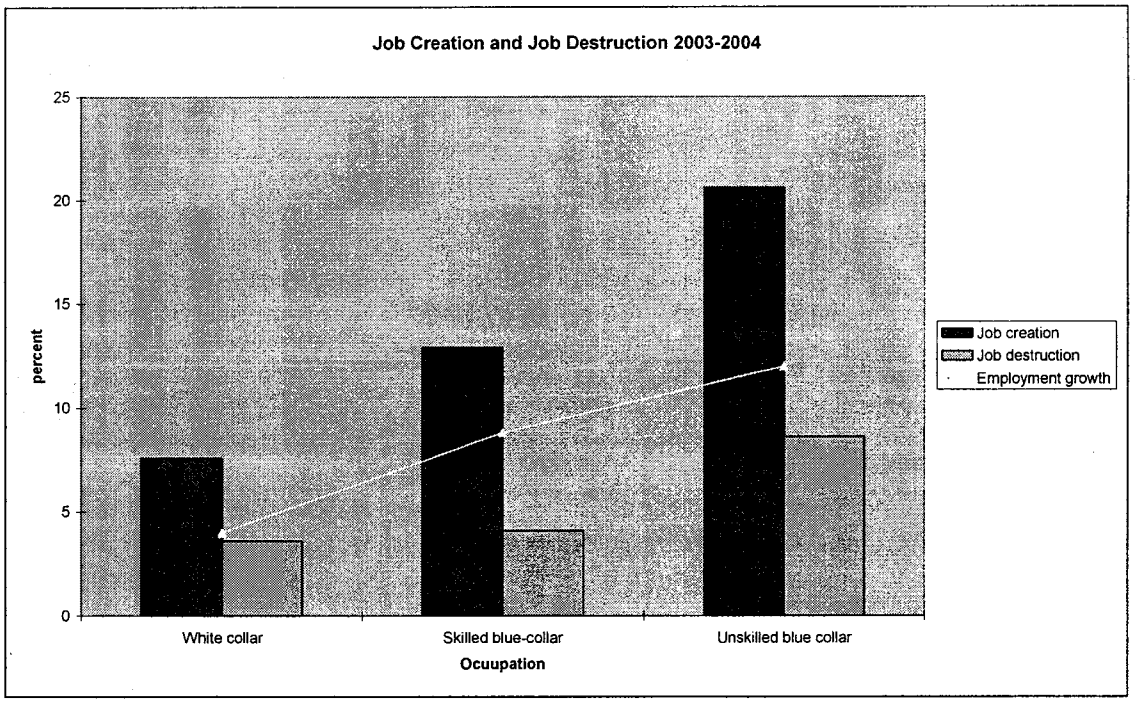


Source: Ukrainian Longitudinal Monitoring Survey, 2003 and 2004.

Multivariate regression analysis indicates that **firm ownership and labor productivity are the two most important independent drivers of firm-level employment growth** (Annex Table A2.1). In contrast, firm size by itself is not an important factor. In addition firm employment performance tends to be better in heavily industrialized regions. To illustrate, all else equal, employment in private firms grew on average by 10 percent faster than in the state owned firms during the 2002-2003. Contrary to common perception, higher labor productivity is conducive to faster employment growth in Ukraine. Other things held equal, firms which were more productive increased employment faster. For example, doubling of labor productivity was associated with nearly 6 percent higher employment growth. Given that on average private firms are more productive than state owned firms, their superior job creation performance comes from both better governance associated with private ownership *and* separately from the more efficient use of factors of production. The finding that employment growth is concentrated in heavily industrialized regions is somewhat surprising and indicating the still important role played by traditional industries. In contrast, in most other transition economies, especially in CEE, it is the diversified regions, with a strong services sector, where job creation is the strongest.

The job creation rate is the highest for unskilled blue-collar workers in Ukraine. The job creation rates for skilled blue-collar workers and especially white-collar workers are substantially lower (Figure 5) than that for unskilled blue collar workers. This is in contrast to most other transition economies of CEE, where the demand is biased toward more skilled labor. The dominance of demand for less skilled manual labor suggests that the Ukrainian labor market is at an early stage of transition.

Figure 5: High demand for simple manual skills

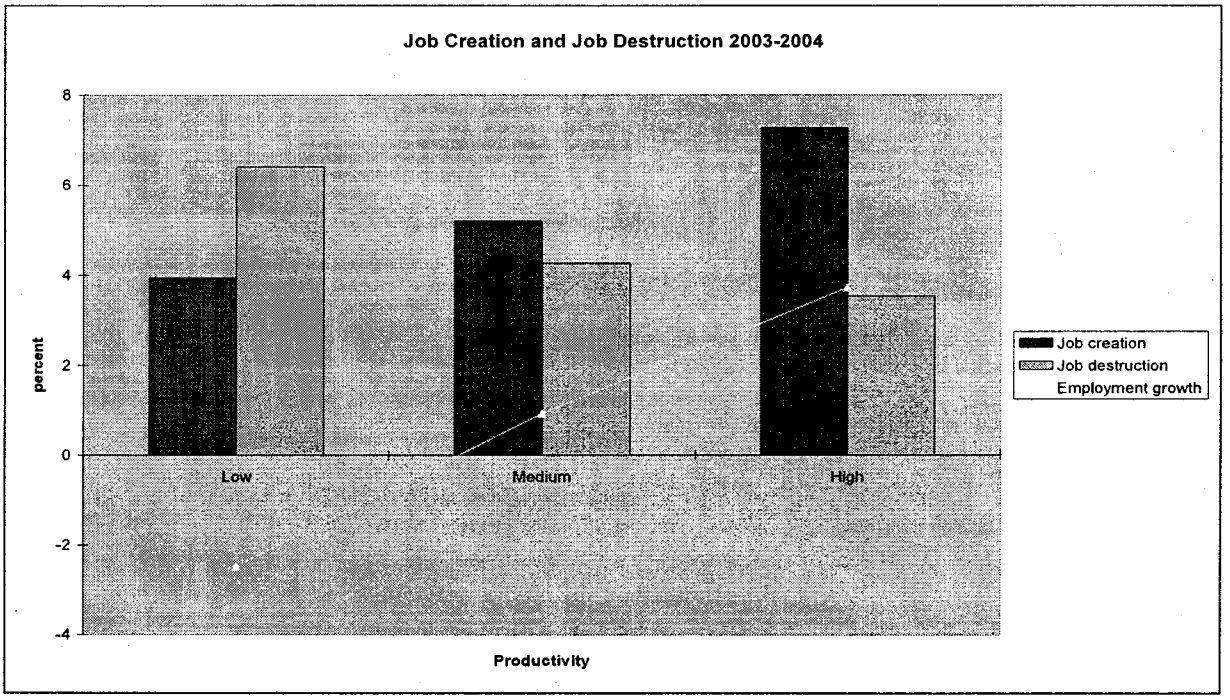


Source: Ukrainian Longitudinal Monitoring Survey, 2003 and 2004.

Jobs that are being created are more productive than those that are being destroyed. Job growth occurs in the top third of the productivity distribution whereas job destruction is concentrated in the bottom third (Figure 6). [10] Thus, enterprise restructuring and associated job reallocation lead to a more efficient use of labor. Labor moves from less productive jobs to more productive jobs, with attendant earnings gains.

But the pace of the job reallocation is relatively slow pointing to delayed industrial restructuring. Although job reallocation notably accelerated in 2004 it still is less intensive than in fast restructuring transition economies of CEE.[11] The formal sector job creation rate was around 5 percent and the job destruction rate around 4 percent in 2004. This means that only about 4 percent of all jobs were reallocated away from shrinking (and likely less productive) firms toward expanding (and likely more productive) firms. In Lithuania or Poland the job reallocation rate was twice as high in the late 1990s (Rutkowski, 2003b). Thus the contribution of job reallocation to productivity growth has been rather modest in Ukraine. This implies that there is still substantial room for enterprise restructuring in Ukraine with attendant productivity improvements, but also lay-offs.

Figure 6: Job reallocation leads to a better use of labor and brings about productivity gains



Source: Ukrainian Longitudinal Monitoring Survey, 2003 and 2004.

[10] The productivity of a job is proxied by the relative wage level.

[11] Brown and Earle (2004) and Konings and others (2003) provide estimates of job reallocation rates in Ukraine for the earlier period. However, the drawback of these studies is that they do not cover the entire economy since the first cited study only covers medium and large enterprises from industry, while the second looks at firms only above a certain size threshold. This report uses instead the Ukrainian Longitudinal Monitoring Survey data which makes it possible to estimate job flows for the entire Ukrainian economy. See Lehmann and others (2005) for details.

Labor is underutilized in Ukraine despite relatively low open unemployment. [12] The unemployment rate was around 8 percent in 2004, which is less than in most transition economies.[13] However, the unemployment rate is not necessarily an adequate indicator of labor market slack. A better measure of the degree of utilization of labor resources is the employment-to-population ratio. By this measure, the labor market performs less well in Ukraine (Figure 7). Less than 60 percent of working age population is employed, which is substantially less than the OECD average of 65 percent, and also less than in more advanced transition economies, for example in the Baltic states. The low level of employment reflects the low labor force participation rate in Ukraine (slightly above 60 percent).[14] Low labor force participation, in turn, tends to be associated with the scarcity of gainful job opportunities. The unemployed become discouraged by the futility of their job search effort and cease looking for a job as they no longer believe that they can find one.

Many workers are underemployed, which is a sign of "hidden" unemployment. For example, one firm in five could produce the same output with fewer workers, pointing to incomplete restructuring (Table 2). And in those firms which report overstaffing, one worker in six could be made redundant without lowering firm's output. That is, many workers – some 3 percent of total employment – hardly contribute to firms' output and will likely be laid-off once enterprise restructuring intensifies, adding to unemployment. However, the scale of underemployment has diminished substantially since the late 1990s, indicating that the enterprise restructuring has accelerated (Table 2).

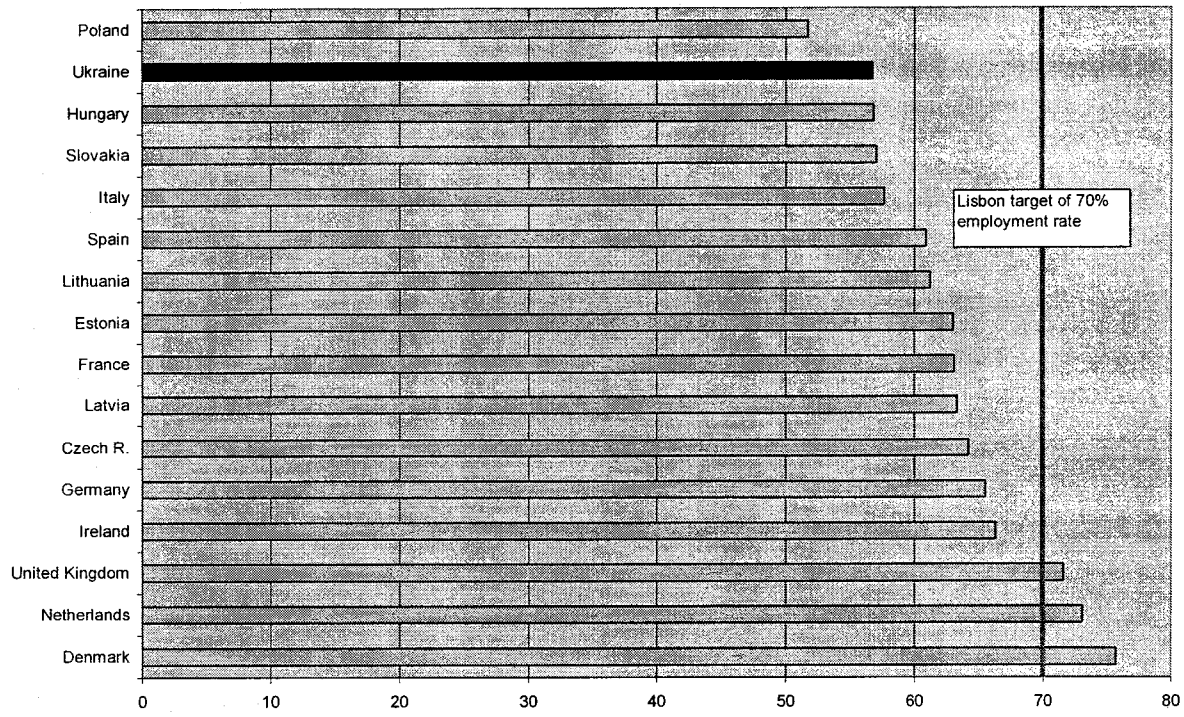
---

[12] Labor force survey data using the ILO definition of unemployment published by the Dhzerskomstat. It is noteworthy, that according to the Ukraine Labor Market Survey (ULMS) the unemployment rate in 2004 was substantially higher and accounted for 14.2 percent. Both surveys use similar (ILO) definition of unemployment, so the discrepancy is due to different samples. While the ULMS estimate may be biased upwards (e.g. due to under representation of "good" performers), it is also possible that the official estimate exhibits some downward bias.

[13] Table A1.2 (Annex) provides key indicators of labor market conditions for selected OECD countries. Three different benchmarks can be applied to assess labor market outcomes in Ukraine: (a) the OECD or EU-15 average, (b) best performing developed market economies (e.g. the U.K.), or (c) best performing transition economies (e.g. the Czech Republic).

[14] Again, according to the ULMS the labor force participation rate in 2004 was below 60 percent and thus significantly lower than the official one.

Figure 7: The employment rate is low in Ukraine
Employment rate in Ukraine and selected transition and EU countries, 2004



Note: The employment rate is the ratio of employment to working age population. The working age is 15-70 for Ukraine and 15 and more for all other countries.
Source: Derzhkomstat (2005)

Table 2: Selected indicators of "hidden" unemployment

	1995	2000	2004
	percentages		
Firms which could produce the same output with fewer workers	37.4	34.1	18.2
Excess employment a)			
Firms reporting over-employment	21.2	23.1	17.2
All firms	7.9	7.9	3.1
Workers on unpaid administrative leave	11.7	13.3	1.3
Involuntary part-time workers	12.9	18.4	7.5
Firms reporting wage arrears	66.5	69.0	30.7

a) Percentage of workforce that could be made redundant without lowering firm's output.
Source: Khan and Zsoldos (2005)

Economic growth brought about an increase in labor market dynamics. Although relatively few new jobs were being created, unemployment has fallen thanks to a higher labor turnover. Chances to escape unemployment increased more than twofold in 2003-2004 compared to the earlier period (Table

3). But quite surprisingly, the current unemployed much more frequently stop looking for a new job and withdraw from the labor force, suggesting a stronger discouraged worker effect. At the same time, inactive workers more often decide to enter the labor market in search of a job, indicating a more favorable labor market conditions. Finally, the greater labor market dynamics is associated with a somewhat higher (25 percent) risk of losing a job. But this greater risk is more than offset by better chances to find a job. As a result, the incidence of long-term unemployment has substantially decreased, from close to 70 percent in the early 2000s to somewhat over 40 percent in 2004. Thus, the benefit of economic growth in Ukraine manifested itself in shorter job search duration and thus lower unemployment rather than in new job creation and higher employment.

Table 3 Labor market transition probabilities, 1998-2004

Flows as a percentage of the origin stock

Flows	1998-2002	2003-2004
Employment to unemployment	3.3	4.1
Unemployment to employment	18.1	38.6
Unemployment to inactivity	7.7	27.3
Inactivity to unemployment	2.5	7.6

Source: Ukrainian Longitudinal Monitoring Survey, Bank staff calculations

But the labor market remains stagnant. Although labor force flows increased in recent years along with economic growth, the Ukrainian labor market resembles those in less dynamic, high unemployment transition economies, such as Bulgaria, Poland or Slovakia. For example, compared to the Czech Republic or Russia, transitions across labor force states (employment, unemployment, out of the labor force) are low in Ukraine. Yearly inflows from employment into unemployment (4 percent) are of similar magnitude as in other transition economies (2 to 6 percent). Outflows from unemployment to jobs (39 percent) are moderate, however, compared with 45-50 percent observed in more dynamic transition labor markets, or 65 percent in the U.S. (Boeri and Terrel, 2002).[15] A substantial fraction of the unemployed (27 percent) withdraws from the labor force during a year, which is a sign of a "discouraged worker" effect and points to limited labor market prospects. All in all, the labor market in Ukraine has become notably more dynamic in recent years, but job prospects are still limited and a large fraction of the unemployed (34 percent) is not able to find a job within a year.

One reason for low unemployment is slow and delayed enterprise restructuring. Figure 8 shows that the major wave of public sector restructuring and associated mass lay-offs in Ukraine took place from the mid to late 1990s, and since then has subsided. Inflows into unemployment have decreased and thus unemployment fell (in the early 2000s the unemployment rate was around 12 percent, significantly higher than the current one). But given the large size of the public sector in Ukraine, major restructuring effort still lies ahead. It again will be associated with large-scale job reallocation and lay-offs, which are bound to bring about at least a transient increase in unemployment. Accordingly, the low unemployment rate is unlikely to be sustainable in the medium run. In Figure A in Box 1, the status of the labor market in Ukraine labor market is represented by the area referred to as "the initial stage" where low unemployment indicates an early rather than an advanced stage of transition.

Unemployment in Ukraine is of long duration. About 50 percent of the unemployed remain so for over a year. In particular, displaced workers – those who lost their job due to enterprise restructuring

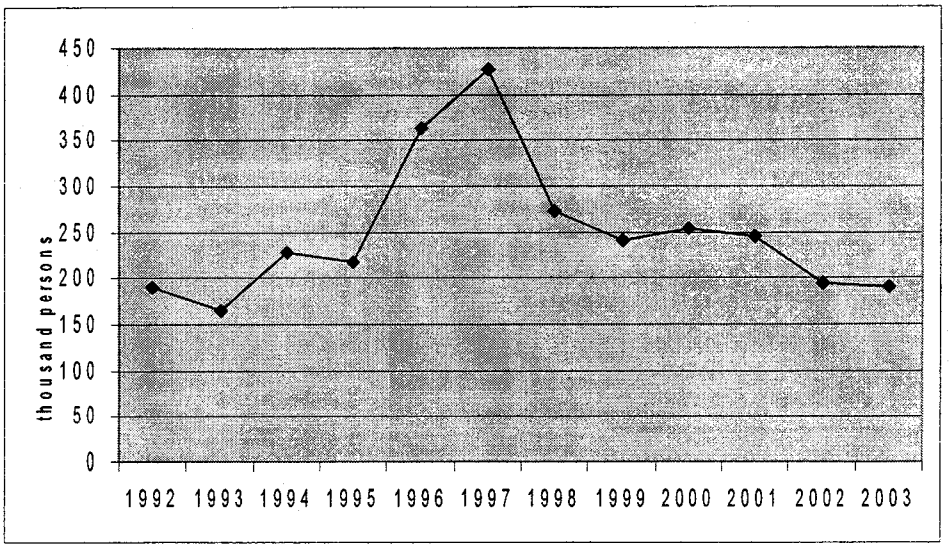
[15] The unemployment-to-employment transition probability was a meager 18 percent before 2003, so doubling of the rate – although from a very low level -- indicates a substantial improvement in labor market conditions in Ukraine in the recent period.

– have a hard time finding a new one. For example, less than a third of the displaced workers found a new job within 3 months after the lay-off during the period of strong economic growth (2000-2003). The long duration of periods of unemployment is characteristic of most of transition economies of CEE and Ukraine is no exception. The contrast with a dynamic labor market, such as that in the U.S. where less than 10 percent of the unemployed are jobless for more than a year, is striking. Long-term unemployment is of particular concern as it is associated with high social cost. Protracted joblessness leads to an erosion of skills and morale and further undermines employment opportunities. Thus, many long-term unemployed eventually withdraw from the labor force. In addition, long-term unemployment is also closely associated with poverty (World Bank, 2005).

The high incidence of long-term unemployment points to structural factors behind unemployment in Ukraine. Specifically, many unemployed lack the skills necessary to find employment. It is estimated that at least 11 percent of the unemployed cannot find a job because his/her skills fall short of those required by employers. It should be noted that this proportion is lower than in most transition economies, where the skill mismatch index usually exceeds 20 percent. This may be a positive sign. However, it may also point to delayed enterprise restructuring. Evidence from other transition economies indicates that the progress of the restructuring is associated with the increase in demand for high, white collar skills and the fall in demand for lower and blue collar skills. In Ukraine this process is still nascent.

Less educated, inexperienced workers in backward regions are hit the strongest by unemployment. The incidence of unemployment varies substantially across worker groups in Ukraine. Young workers (15-24 years old) are about twice as likely to be unemployed as prime age workers (24-49 years old), which is a typical pattern observed in most countries. However, unemployed young workers have much better chances to find a job than their older colleagues, and as a consequence long-term unemployment among young workers is less frequent (34 percent against 52 percent for prime-age workers). As in other transition economies, unemployment among workers with primary and secondary education is much higher than among workers with university education (for the latter group the risk of unemployment is roughly half that for less educated workers). At the same time, workers with primary education find jobs quickly, so the incidence of long-term unemployment is relatively low for this group (36 percent). This is in sharp contrast to experience in other transition economies and supports the claim that the demand for less skilled, manual labor is still strong in Ukraine. Unemployment is negligible (3.2 percent) in the capital region (Kyiv), while it is almost 18 percent in the Central and Northern region. Such large regional disparities in labor market conditions, with strong concentration of job creation around the capital, are not specific to Ukraine and are prevalent also in other transition economies. Finally, there is no difference in the incidence of unemployment between men and women; the risk of losing a job is virtually the same for both genders (slightly higher for men). However, unemployed women have a somewhat worse chance of finding a new job (35 percent for women against 42 percent for men in 2003-2004). In addition, it has been observed that women have a greater tendency to withdraw from the labor force after a period of joblessness, indicating that their labor market attachment is slightly weaker.

Figure 8: The pace of public sector restructuring has slowed down
Mass Lay-offs, 1992-2003



Source: State Statistics Committee of Ukraine; http://www.ukrstat.gov.ua

Productive job opportunities are scarce despite low unemployment. This is because of the small size of the job generating new sector of the economy and of the widespread informality often associated with low productivity. A large fraction of jobs are in the public sector which is downsizing, and barely hiring new workers. Thus, employment opportunities in the public sector are limited and will increasingly be so, once the sector is further restructured and exposed to stronger competitive pressure. While the new private sector is expanding and creating jobs on a net basis, it is still relatively small; thus it hires a relatively small number of workers.

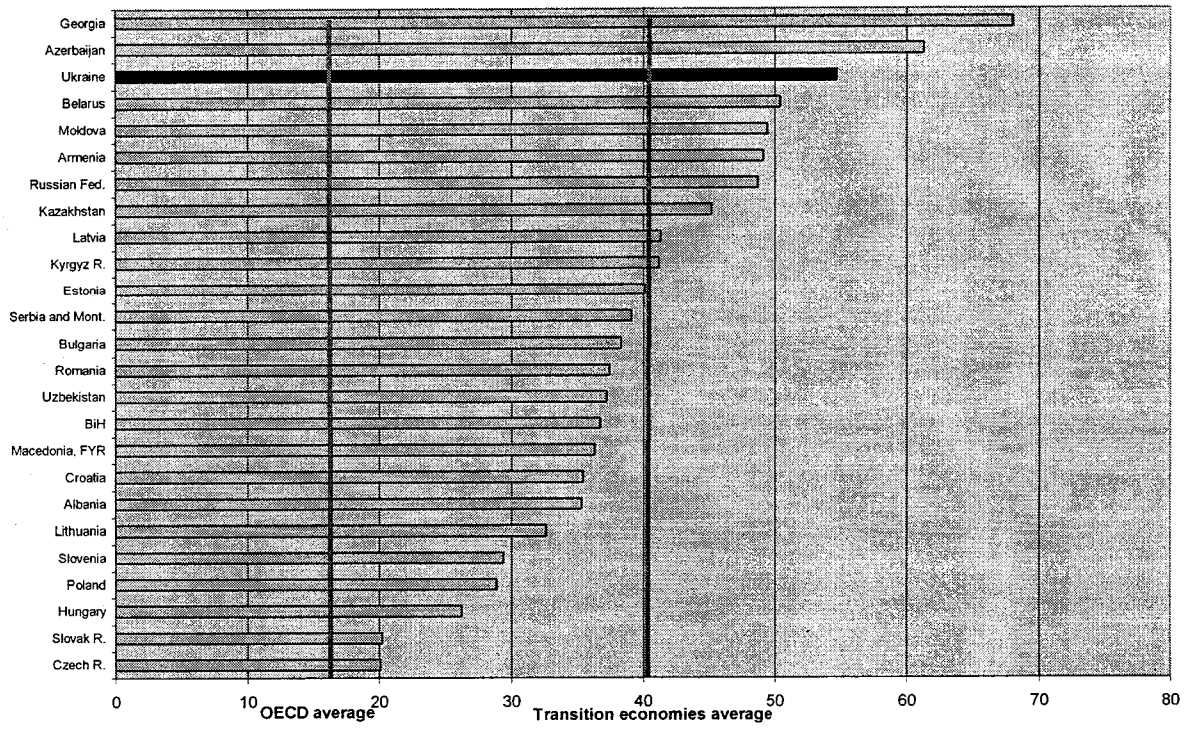
Many jobs are in the informal sector. The informal sector represents a large, according to some estimates even dominant, part of the Ukrainian economy (Figure 9). For example, the informal sector as a share of GDP is estimated at 55 percent (Schneider, 2005). This is much greater than in more advanced transition economies, such as Poland (less than 30 percent), the Czech Republic or Slovakia (about 20 percent). Estimates of informal employment are more modest, but still substantial: one in five workers is employed in an unregistered job.[16]

Informal sector employment tends to be of low productivity. Young, poorly educated and unskilled blue-collar workers are disproportionately represented among the informal sector workers. For example, unskilled workers account for one-third of informal sector employment, compared with less than one-fifth of formal sector employment. About 25 percent of the informal sector workers do not have secondary education, twice as much as in the formal sector. In addition, informal jobs are concentrated in sales (34 percent), agriculture (25 percent), construction (12 percent) and services (8 percent) - industries

[16] According to the ULMS 2004. Derzhkomstat, using the Labor Force Survey, estimates the informal sector represents about 16 percent of total employment. The measurement of the informal sector employment is difficult and depends on the applied methodology and data sources. Results are subject to a wide margin of error. The point that is being made her is that international comparison carried out using a standard methodology indicates that the informal sector in Ukraine is larger than in most neighboring countries. Further research is necessary to obtain more precise estimates of informal sector employment.

where productivity is relatively low. Finally, a majority (close to 80 percent) of the informal sector workers are either self employed, or employed in micro firms.[17]

Figure 9: The informal sector in Ukraine is among the largest in the region
Informal sector as a percentage of GDP in 2002-2003



Note: The size of the informal economy was estimated using DYMIMIC and currency demand methods.
Source: Schneider (2005)

The informal sector offers better earning opportunities than the formal sector. Controlling for individual and firm specific characteristics, informal sector workers receive a wage premium from 10 percent (at the bottom of the wage distribution) to 15 percent (at the top of the wage distribution). This suggests that workers are not only "pushed" into the informal sector by lack of job opportunities in the formal sector, but also "pulled" into it by better earning prospects. However, the incidence of low-pay is somewhat higher in the informal sector than in the formal sector.[18]

The informal sector cushions the impact of unemployment. Casual, temporary jobs in the informal sector seem to be a source of income to many among the (usually) unemployed. Data show that about 30 percent of the unemployed find casual employment in the informal sector. Moreover, one-third of the jobless escape unemployment by finding a job in the informal sector.

The labor market has become segmented but workers move between the formal and the informal sector. Theoretically, labor market segmentation means that there are economic or regulatory

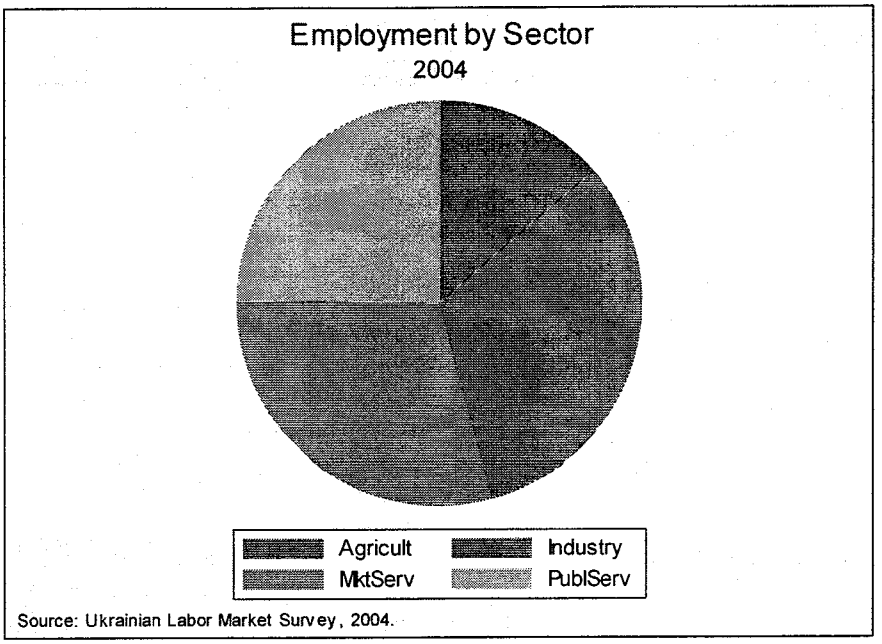
[17] Micro firms are firms employing up to 10 employees.
[18] If (as it is customary) low pay is defined as less than two-thirds of the median earnings, then the incidence of low pay (percentage of workers, who are low-paid) is 25 percent in the informal sector and 20 percent in the formal sector.

barriers which prevent workers from moving between sectors. Thus, the larger the flows between sectors, the weaker the cause for the segmentation hypothesis. Naturally, some workers employed in the formal sector move to the informal sector (e.g. due to a job loss); however, this fraction at 3 percent (per year) is very small in Ukraine. More tellingly, some 15 percent of informal sector workers move to the formal sector within a year. This is a significant fraction but it does not seem to invalidate the segmentation hypothesis.

All in all, the data do not support the notion that workers in Ukraine are trapped into "bad" informal sector jobs. The informal sector is an important source of employment and offers relatively high wages. Also for many workers informal sector employment is a transient state and a stepping stone into formal sector employment. However, from the worker welfare standpoint, it is uncertain whether somewhat higher informal sector earnings fully compensate for the lack of employment related benefits and less job security. Without knowing this it is not possible to ascertain whether "push" or "pull" factors are more important in explaining workers' movements into the informal sector.

Jobs have moved from industry to services, and the services sector has become a major source of jobs. The market services sector accounts for some 30 percent of total employment, of which almost one-third is in the informal sector. Public and social services represent an additional 25 percent of total employment, so that over half of all jobs is in the services sector (Figure 10). Thus, there has been considerable movement of labor in Ukraine away from manufacturing (overdeveloped during the central planning era) toward services, which were underdeveloped. As a result of de-industrialization, the industry's share in total employment is presently only about 32 percent. This employment structure, dominated by services, is typical of more advanced transition economies of CEE and of developing countries with GDP per capita level similar to that in Ukraine. However, widespread informality in the services sector means that the challenge to develop a truly modern, productive services sector still lies ahead in Ukraine.

Figure 10: Majority of jobs are in the services sector



Source: Ukrainian Longitudinal Monitoring Survey, 2004.

Wage flexibility is limited which might inhibit labor market adjustment. Wages still are determined in a rather centralized way, especially in public and privatized firms. Trade unions play an important role in wage determination while the role of employers tends to be limited. Resulting wage rigidities might contribute to labor market imbalances, particularly to unemployment, with wage adjustment being critical for attaining labor market equilibrium. Factors pointing to limited wage flexibility include significant wage growth despite unemployment, relatively high minimum wage, union wage premia, industry wage premia, and finally modest returns to education.

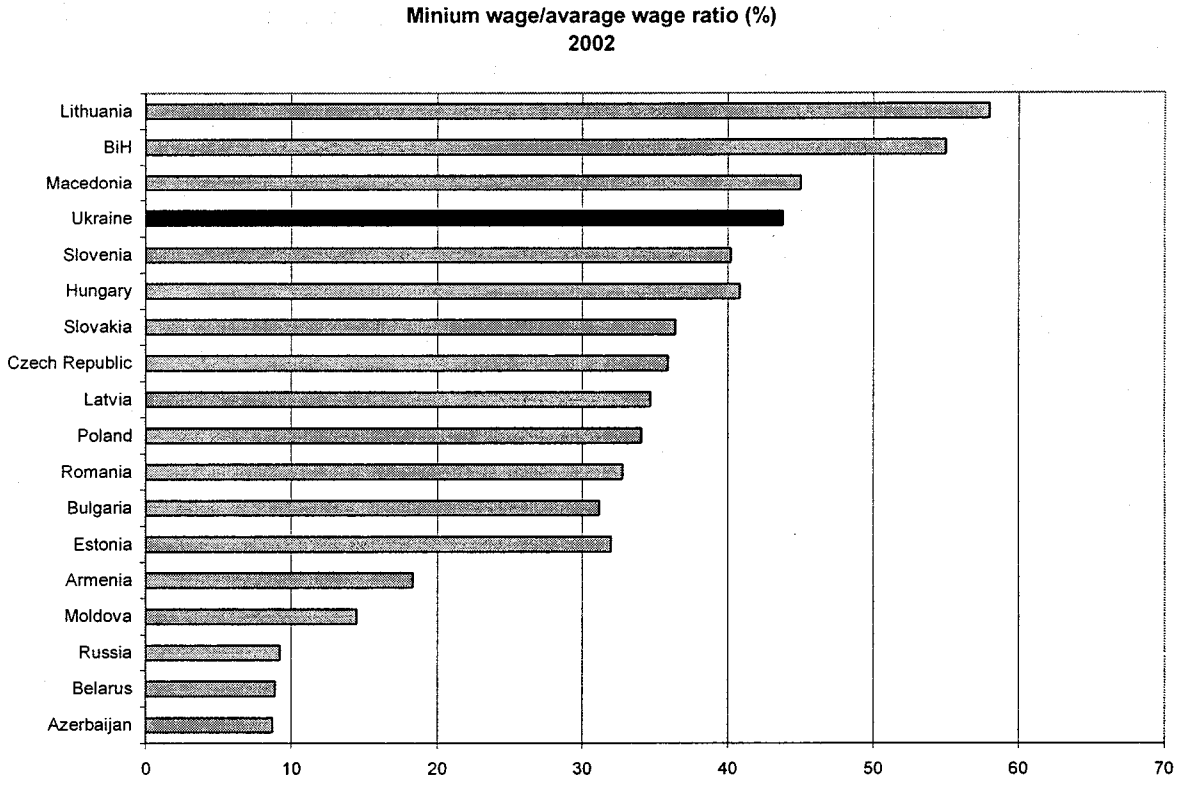
Wages grew in excess of productivity in recent years raising unit labor cost. Real wages have grown at an impressive rate of 19 percent per year since 2000, faster than GDP per worker (which is a proxy for productivity). Such a fast growth in real wages reflects insider power in wage determination. However, the resulting increase in unit labor cost dampened labor demand and was one source of jobless growth. Thus, the increase in labor demand associated with output growth benefited the employed (insiders), rather than the unemployed (outsiders).

The minimum wage is high relative to the average wage but it is not enforced. The statutory minimum wage hovers around 40 percent of the average wage in Ukraine.[19] This is high by standards of CEE economies, where the minimum wage in most countries is less than 35 percent of the average wage (Figure 11). However, as is shown below, the minimum wage often is not enforced. This suggests that trade unions are relatively strong at the national level (where the minimum wage is determined), but less

[19] The minimum wage accounted for 42 percent of the average (mean) national wage in January 2005. However, this estimate may be biased upwards due to the reportedly widespread practice of underreporting of wages as a means of tax evasion. If so, the average wage is underestimated and, consequently the minimum wage-to-average wage ratio is overestimated. Given available data it is no possible to determine how large is the bias, i.e. what is the actual minimum wage-to-average wage ratio. This issue requires further research.

strong at the firm level, as strong unions would not permit their members to be paid less than the minimum wage. The minimum wage in Ukraine plays a number of functions, and thus its change has not only welfare but also fiscal implications (see Box 2).

Figure 11 The minimum wage in Ukraine is high relative to the average wage by regional standards



Source: UNICEF TransMONEE database; Bank staff calculations.

The minimum wage is aimed to protect earnings of those who have jobs; however, it is likely to price less productive workers out of employment. Low skilled, inexperienced (young) workers in economically depressed regions of the country, whose prevailing market wage is substantially lower than the national average, are particularly likely to be negatively affected. Figure 12 shows that **while the minimum wage is hardly binding for skilled manual workers, it cuts deep into the wage distribution of unskilled workers.** This means two things. First, that the minimum wage is not enforced, as many workers earn less than the minimum wage. Second, if enforced, the minimum wage could have a significant detrimental effect on employment of unskilled workers. Many workers who currently earn less than the minimum wage would lose their job because employers would not want to keep workers whose productivity is lower than the wage they are to be paid.

Box 2. The Functions and Effects of the Minimum Wage in Ukraine

The minimum wage in Ukraine plays four main functions. First, it protects workers from exploitation by employers and ensures some socially acceptable minimum consumption level. Second, it provides a base for the wage structure in the public sector, where wages for different occupations and skill levels are expressed as a multiple of the minimum wage. Third, it provides a base for determining some social security benefits (e.g. military pensions). Finally, the minimum wage is intended to prevent tax evasion by determining the minimum income base for social security contributions and taxes. Consequently, an increase in the minimum wage will have a number of effects, which include:

A. Effects on worker welfare

- An increase in nominal wages of low-paid workers.[a)]
- The worsening of employment chances of vulnerable workers (youth, inexperienced, and low-skilled workers) if the minimum wage is set above the market clearing wage for these worker groups.
- A (temporary) reduction in earnings inequality.
- A reduction in poverty if two conditions are met: (a) significant number of the poor are wage earners, and (b) minimum wage earners are predominantly members of poor families.[b)]

B. Fiscal effects

- Increase public expenditures due to an increase in the public sector wage bill.
- Increase public expenditures due to an increase in spending on social benefits.
- Either increase or decrease the revenues of social security funds. The revenues will increase only if there is no significant disemployment or informalization effect.[c)] These effects will be small if (as it is often claimed in Ukraine) the undeclared wage payments represent a significant part of the total wage of vulnerable workers, as the increase in the minimum wage will simply formalize previously undeclared wage payments. However if the disemployment or informalization effects are significant, the revenues can decrease.

Given this multitude of effects, of which some are positive and some are negative, it is hard to predict the net effect of the minimum wage increase on social welfare. This makes the minimum wage policy difficult in Ukraine. One instrument – the minimum wage – is meant to meet too many objectives. The way around is to reduce the number of functions assigned to the minimum wage. The minimum wage should be primarily used as a wage floor to protect earnings of low-paid workers. It should not be used to determine the level of social benefits, or as a minimum base for social security contributions and taxes. The latter function can be played by a separate minimum tax base, which can be set above the minimum wage. Thanks to this the wage structure will be more flexible, while tax revenues will be protected.[d)]

Even if the function of the minimum wage is limited to that of protecting earnings of the low-paid workers, determining the "right" amount of the minimum wage is a difficult balancing act. On the one hand, the minimum wage needs to meet the criterion of fairness and ensure some minimum consumption standard. On the other hand, it should not price low-productivity workers out of employment. Thus, a sound minimum wage policy needs to be based on an analysis of the earnings distribution and should follow some key rules to ensure that the benefits of the minimum wage policy exceed its costs.[e)]

Box 2., cont.

a) If the increase in the minimum wage spills over the entire earnings distribution then it may cause a price increase which lead to a fall in the real value of the minimum wage.

b) In practice (a) most of the poor (the disabled, the retired, the unemployed) do not earn wages and thus do not benefit from the minimum wage increase, and (b) minimum wage workers are secondary earners in non-poor families, so the increase in the minimum wage benefits non-poor families. Accordingly, the minimum wage is not a well-targeted and effective anti-poverty policy, and the positive effect of the minimum wage increase on poverty in most countries has been found to be negligible or at best limited (Rutkowski, 2003a). The effect on poverty can be negative if the disemployment effect of the minimum wage increase is substantial

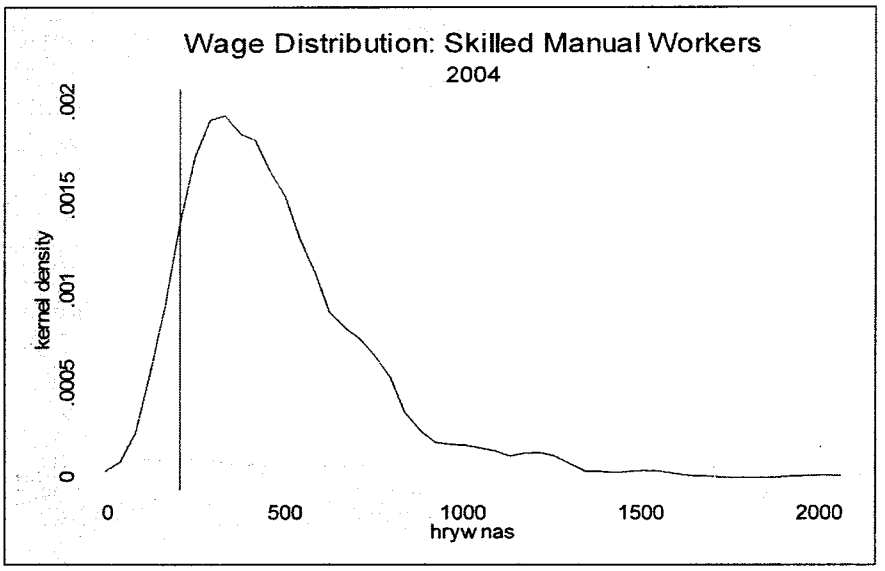
c) The informalization effect occurs if the increase in the minimum wage leads to a shift of employment away from the formal sector towards the informal sector. The disemployment effect occurs if the increase in the minimum wage causes a fall in employment.

d) The minimum tax base will "formalize" informal (envelope) wage payments, a problem which is currently addressed by means of the minimum wage policy. But the potential disemployment effect of raising the minimum tax base is lower than that of raising the minimum wage.

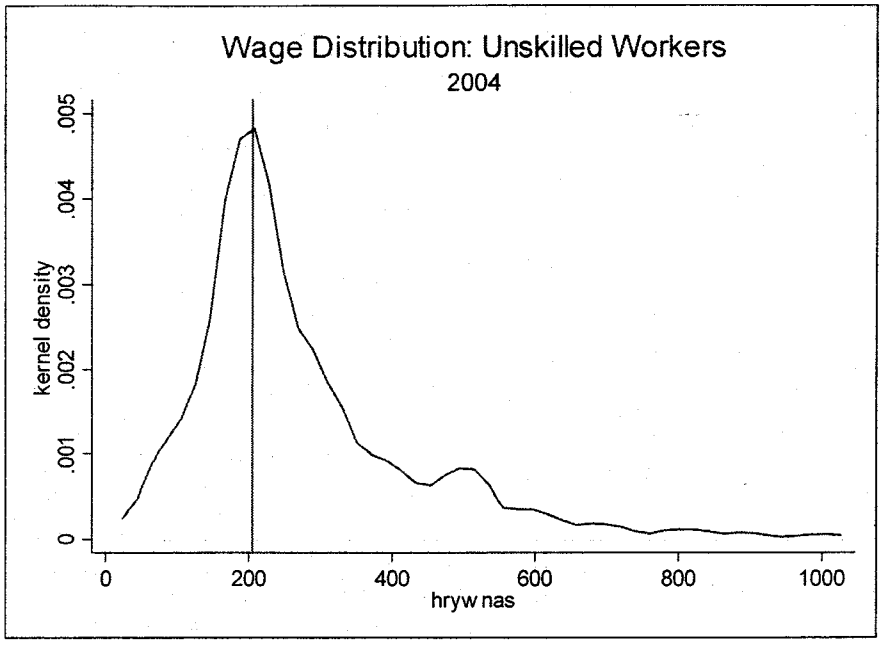
e) The principles of a rational minimum wage policy are presented in Rutkowski (203a).

Figure 12: The minimum wage accounts for a high percentage of the market wage of low-skilled workers but is not enforced

Panel A



Panel B



Note: The vertical line indicates the minimum wage (205 hrywnas in June 2004).
Source: Ukrainian Longitudinal Monitoring Survey, 2004.

Workers covered by collective agreements and trade union members enjoy a wage premium. Multivariate regression analysis reveals, other things being equal, that formal sector workers who are covered by collective agreements earn higher wages. For example, a worker employed in a firm covered by a collective agreement on average earns almost 10 percent more than a similar worker employed in a firm not covered by a collective agreement (Annex Table A3.1).[20] Thus bargaining agreements raise wages above the competitive level. This lowers employment in the covered sector and forces some workers to move to the uncovered (informal) sector.

Significant industry wage premia are another symptom of non-competitive wage determination in Ukraine. Multivariate regression analysis shows that a worker's wage depends not only on his/her personal traits and on firm characteristics, but also on industry affiliation. For example, workers employed in manufacturing earn significantly more than similar workers employed in the services sector. To a large extent this is a legacy of the communist system, which awarded high wage premia to workers employed in "strategic" industries, such as metal processing, mining, etc. The existence of industry wage premia means that firms share rents with their workers, but again at the expense of those whose higher than competitive wages price them out of employment.

Wage premia to education have been low. Only very recently (in 2004) the rate of return to one year of schooling increased to 6 percent (from around 4 to 5 percent), a rate still significantly less than in other transition economies of CEE. For example, in Poland the rate of return to schooling sharply increased in the early years of the transition and already reached over 7 percent in the mid 1990s (Rutkowski, 1996). With some delay, a similar process has occurred in Russia (Gorodnichenko and Sabirianova, 2004). This much delayed increase in returns to education in Ukraine indicates either that the wage structure only slowly adjusts to the changes in demand for skills, or that the increase in demand

[20] However, the effect of bargaining coverage/union membership is hard to disentangle from that of firm ownership and size. Also the size of the effect depends on the specification of the regression equation.

for high skills has been more limited in Ukraine than in other transition economies. The latter reason would be consistent with slower opening of the Ukrainian economy and a slower pace of technological progress (which is biased towards skilled labor). In either case, the low rate of return to education indicates that the Ukrainian labor market is at a relatively early stage of transition.

Wage distribution has decompressed during the transition in Ukraine, as it has in other transition economies. However, the actual degree of wage inequality is unclear; estimates range from moderate to high, depending on the data source.[21] At face value, the high minimum wage and high union bargaining coverage should act as factors limiting wage dispersion. But as mentioned above, many firms do not comply with minimum wage regulations, and unions cannot enforce compliance even in the unionized sector. It is also not clear whether the increase in wage dispersion is associated with greater economic efficiency. For this to be the case wage differentials would need to reflect productivity differentials among workers. But this is not necessarily the case. Wage differentials might well reflect various rents (e.g. monopoly rent) which proliferate in a non-competitive environment. Evidence presented above suggests that such rents indeed exist in the Ukrainian economy and are partly captured by workers, especially in the unionized sector. But further research is necessary to determine the efficiency of the wage structure in Ukraine.

Trade unions play an important role in shaping industrial relations in Ukraine. The unionization rate is high and so is union bargaining coverage. At the same time, employers representing the new private sector are only beginning to organize themselves and articulate their interests. In the *formal* sector the unionization rate reaches 70 percent and the union bargaining coverage is still higher at close to 90 percent.[22] These rates are very high by the standards of other transition economies and those of OECD. In virtually all CEE countries, the unionization and bargaining coverage rates have declined sharply along with the growth of the private sector and a move toward decentralized bargaining structures (i.e. from industry to firm level bargaining). For example, in Poland union density has fallen to less than 20 percent and union bargaining coverage is around 40 percent. The OECD average is 20 and 35 percent, respectively (O'Keefe, 2005). The weakness of the employers' representation is reflected in the fact that majority industry level collective agreements are reached *not* with representatives of private business, but instead with line ministries which represent the State as the main employer.[23]

High union density and bargaining coverage in Ukraine reflect an underdeveloped private sector. Expectedly, the trade union stronghold is large in public as well as privatized enterprises. For example, the union density rate is some 80 percent in the public sector and less than 10 percent in the new private sector (Figure 13). In the public sector unions tend to be, for historical reasons, linked to the government.[24]

Strong position of trade unions leads to inefficiencies in collective bargaining (Box 3). First, their close ties to the government often give them an upper hand in negotiations with private sector

---

[21] According to the ULMS (which is a household based survey), the Gini coefficient (which is a summary measure of income inequality ranging from 0, when all incomes are equal, to 1, when total income is in the hands of one person) amounts to 0.32, which indicates moderate wage inequality (e.g. the same as in Poland and most other European transition economies). However, according to the UNICEF TransMONEE data (coming from the employer based survey) the Gini coefficient is 0.42, which indicates a high degree of wage inequality, characteristic of most CIS countries.

[22] The unionization rate is the percentage of workers who are members of trade unions. The union bargaining coverage rate is the percentage of workers who are covered by collective agreements. For the whole economy these rates are 57 and 70 percent, respectively (according to the ULMS 2004).

[23] Only 13 out of 77 sectoral agreements were concluded with the association of employers. The rest were signed instead by relevant line ministries.

[24] Under communism trade unions played a role of a "transmission belt" of government decisions to workers.

employers. Second, collective bargaining where unions represent public sector workers while employers' organizations represent private business lacks the common object. There is a representation mismatch which can only be addressed by a development of independent, private sector unions and by the decentralization of collective bargaining.

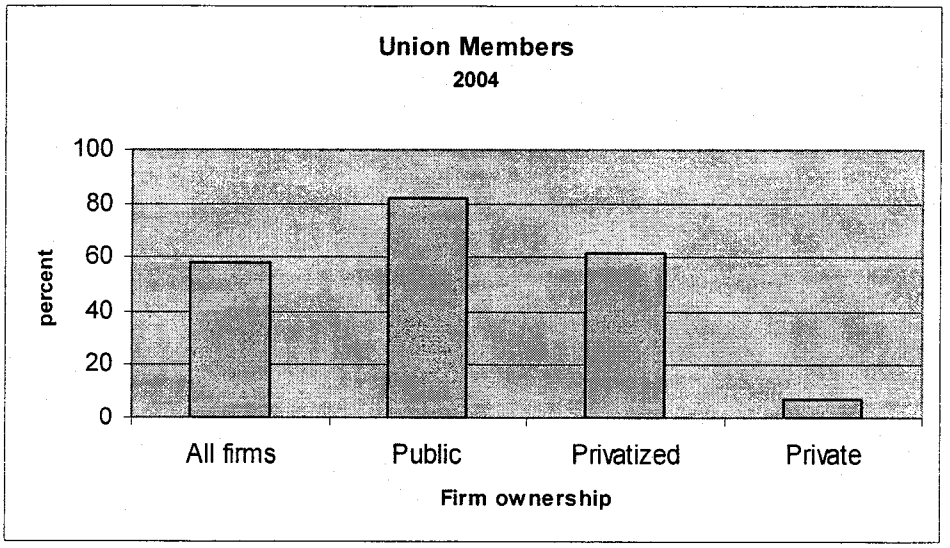
Box 3. Collective bargaining needs to meet some conditions to be efficient, but these conditions are rarely met at an early stage of the transition

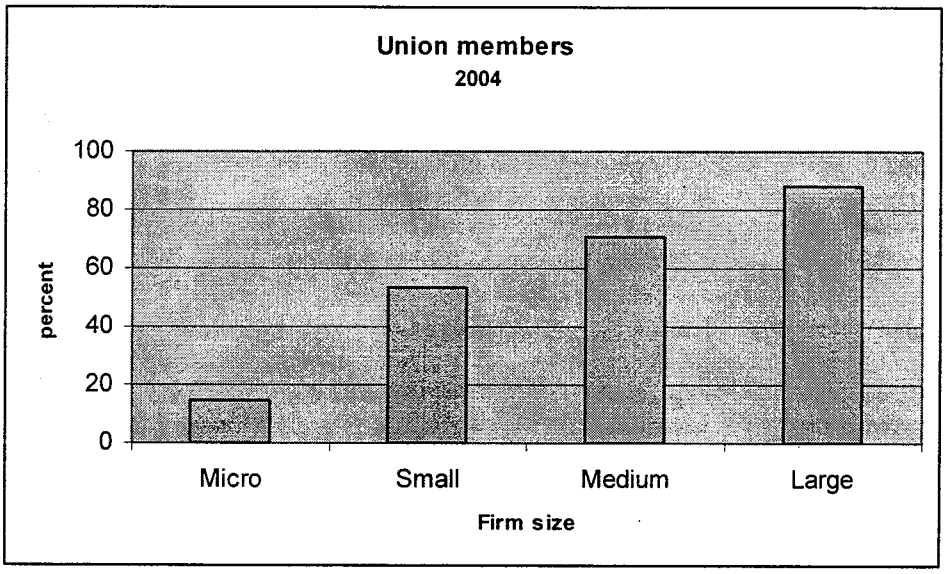
Four conditions need to be met for collective bargaining between trade unions and employers' organizations to yield efficient outcomes.

- **Adequate representation.** At the national and sectoral level the bargaining parties – trade unions and employers' organization -- should represent a significant fraction of the workforce and firms in an identifiable sector of the economy. Criteria for representativeness should be established and representativeness should be periodically verified. Moreover, participation in the bargaining should be voluntary, inter alia to ensure that the interests of bargaining parties are aligned with the interests of workers and firms they represent.
- **Balance of powers.** Bargaining parties should be of approximately equal power, i.e. bargaining to be efficient cannot be dominated by one particular party. This requires that all parties have an adequate institutional representation and the formal of informal bargaining framework does not favor one party. Bargaining should be voluntary in the sense that no party can be compelled to sign an agreement which it does not accept (i.e. each party should have the veto right).
- **Coverage limitation.** Collective bargaining agreements should be binding only to signatories of the agreement, and parties that decide not to enter the negotiations should not be bound by the terms of the agreement. This implies that mandatory extension of bargaining agreements to non-participating employers should be precluded. Also an opt-out option for firms which find it too costly to comply with the agreement should be granted..
- **Right to renegotiate.** Agreements should be signed for a limited period of time so that to enable both parties to renegotiate their provision as economic conditions change. This is particularly important during the transition when firms are exposed to increasing competitive pressures and often no longer can afford paying benefits granted under the old regime.

In many transition economies, including Ukraine, for historical reasons at least one of these conditions is not met, which leads to skewed bargaining outcomes. Existing employer organizations often represent mainly the interests of the large, state owned or privatized firms and not those of small, *de novo* private firms. Public sector trade unions bargain with private sector employers. The bargaining process is often dominated by trade unions, while the interests of employers are poorly articulated and not taken into consideration. Industry-wide agreements are concluded that cover firms, which were not represented at the bargaining table. Finally, agreements are sometimes open-ended (or long-term) and cannot be renegotiated if one party refuses to do so, which deprives the other party (as a rule employers) of the possibility to adjust their content to the changing economic environment. As a result, national and industry-level collective bargaining agreements provide for wage growth and generous work related benefits which are not sustainable once firms face hard budget constraint and become exposed to competition. They raise labor cost and thereby reduce employment in the covered sector. These shortcomings of the bargaining system need to be addressed to make collective bargaining an efficient tool for reconciling interests of labor and capital and to yield socially acceptable and economically efficient outcomes.

Figure 13: Trade unions are mostly present in large public and privatized firms





Note: micro = up to 10 employees, small = 11-50, medium = 51-250, and large = more than 250 employees.
Source: Ukrainian Longitudinal Monitoring Survey, 2004.

The strength of unions manifests itself more in their ability to influence labor legislation than their ability to ensure its enforcement. As shown below, the draft labor code exhibits a pro labor bias placing trade unions on the stronger side. Also, as earlier demonstrated, trade unions' influence is a factor behind strong wage growth capitalizing on the productivity growth in the recent period. On the other hand, unions seem to have less power to control developments within private firms, failing to ensure compliance with labor regulations, (for example minimum wage regulations).

II. WHAT INHIBITS LABOR MARKET PERFORMANCE IN UKRAINE?

Two broad sets of factors influence labor market performance: the investment climate, and labor market institutions and policies. Investment climate matters because it determines the rates of entry and growth by firms, and thus, the pace of job creation. If the investment climate is poor, few new firms enter the market and existing firms do not expand, which depresses the demand for labor. Labor market institutions and policies – such as employment protection legislation, minimum wage and labor taxation – have a direct bearing on labor demand and labor supply. For example, strict employment protection legislation (EPL) raises the cost of labor adjustment; it discourages employers from hiring workers in the period of economic upturn because they want to avoid future firing costs in the period of downturn (Betcherman and others, 2001). There is substantial room for improvement on both of these dimensions in Ukraine. These factors are further examined below.

Poor governance, uncertainty, administrative barriers and poor access to finance constrain entry of and growth by firms in Ukraine. Figure 14 uses entrepreneurs' perceptions as a basis for identifying major obstacles to business operation. The figure highlights those obstacles that figure more prominently in Ukraine than in other CEE transition economies. The figure makes it clear that Ukraine faces a formidable challenge to reduce corruption, lessen regulatory and economic policy uncertainty, and remove administrative barriers which constrain business activity. Improving access to finance is also critical to spur investment and eventually job creation (World Bank, 2004).

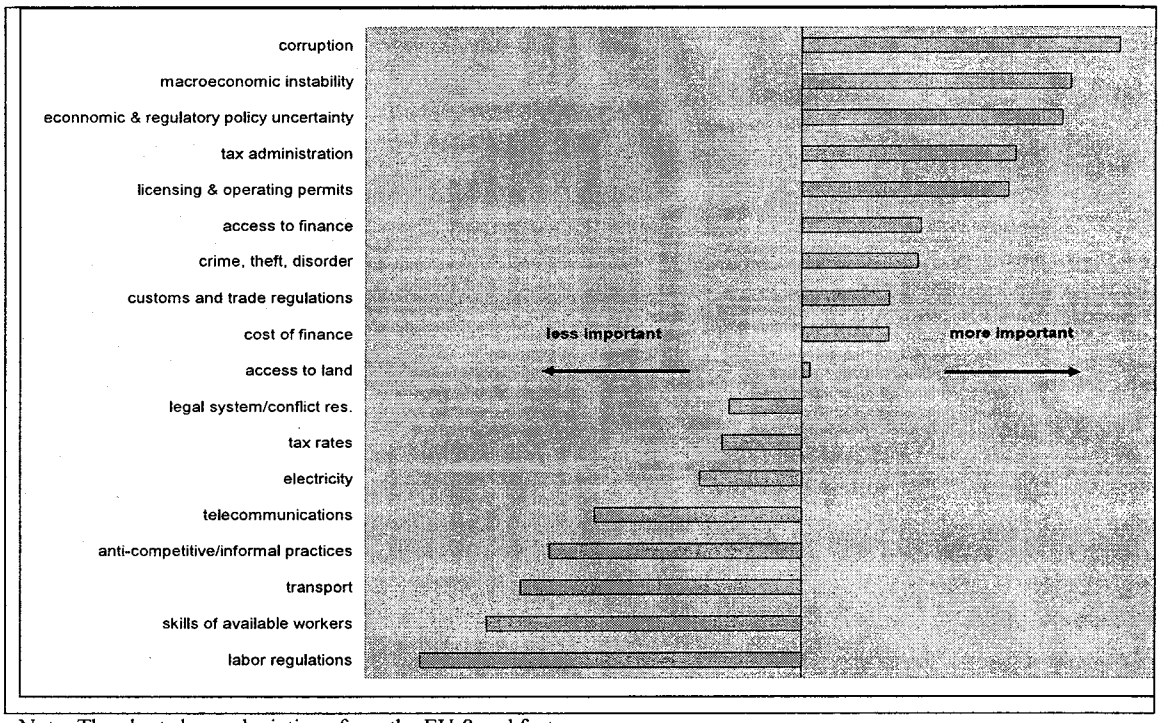
High tax rates are viewed as one of the most important constraints. Some 40 percent of entrepreneurs in Ukraine see high tax rates as a major obstacle to the operation and growth of their firms.[25] In particular, payroll taxes are blamed for raising the labor cost and limiting hiring. However, these results need to be put into perspective. There is no doubt that taxes on business limit economic activity, and taxes on labor are likely to discourage hiring. At the same time, taxes pay for important public services and social benefits and, as such, are part of all modern economic systems. In fact, taxes are seen as less of a constraint in Ukraine than in other CEE countries (see Figure 14). It must also be noted that payroll taxes are lower in Ukraine than in most CEE countries (Figure 15). Thus, taxes do add to labor costs in Ukraine, but not more so than in other countries. The problem is thus not taxes per se, but inefficiencies in the public, including social, expenditure system.

Labor regulations are not seen by entrepreneurs as a significant constraint. In fact, as Figure 14 shows, they are viewed as the least significant obstacle to firms' operation and growth, considerably less important than in other CEE countries. For example, only 22 percent of Ukrainian firms see labor regulations as a significant obstacle, whereas in neighboring Poland the proportion is as high as 50 percent. The fact that labor regulations are not perceived as a major obstacle by employers can mean three things. First, labor regulations might not matter because they are not enforced and widely evaded. Second, they present an obstacle to firm growth, but are less important than other obstacles. Finally, labor regulations might not be seen as a binding constraint because of the dominance of the still unrestructured firms which have not yet gone through downsizing and thus have not incurred dismissal costs. In any case, the implication is that, although labor regulations are presently not viewed as a major obstacle, they are likely to

[25] High tax rates rank as a third most important obstacle to firm operation and growth in Ukraine (after macroeconomic instability and regulatory and policy uncertainty). However, taxes are perceived as less of an obstacle in Ukraine than in most EU-8 countries, and that is why they are shown as less important in Figure 3, which shows *relative,* rather than *absolute,* importance of various obstacles.

become one as structural reforms progress, as has happened in other, more advanced transition economies (World Bank, 2005). Improvements in business environment, a faster pace of enterprise restructuring and a better enforcement capacity will all cause labor regulations to exert an increasing effect on enterprise performance.

Figure 14: Corruption, uncertainty, administrative barriers and poor access to finance are seen by employers as major obstacles to firm operation and growth



Note: The chart shows deviations from the EU-8 and factor average scores.
Source: EBRD-World Bank Business Environment and Enterprise Performance Survey, 2002.

However, on paper employment protection legislation is extremely stringent in Ukraine. According to the *Doing Business* indicators, employment protection legislation in Ukraine is significantly stricter than in other CEE countries and much stricter than in most OECD countries. Employment relations are overregulated and firing costs are extremely high (Table 4).

Table 4: Employment protection legislation: Ukraine against selected CEE and OECD countries, 2004

Economy	Difficulty of Hiring Index	Rigidity of Hours Index	Difficulty of Firing Index	Rigidity of Employment Index	Firing Costs (weeks)
Bulgaria	33	40	10	28	30
Croatia	61	60	50	57	55
Czech R.	44	20	20	28	22
Estonia	11	80	40	44	33
Hungary	11	80	30	40	34
Latvia	78	20	50	49	42
Lithuania	33	60	30	41	34
Poland	11	60	30	34	25
Romania	78	60	50	63	98
Russia	0	60	20	27	17
Slovakia	0	20	10	10	17
Slovenia	28	80	50	53	47
Ukraine	**33**	**80**	**80**	**64**	**94**
Memorandum					
OECD: High income	26	50	26	34	40
of which low unemployment OECD					
Denmark	0	40	10	17	39
Ireland	28	40	20	29	52
UK	11	40	10	20	25
US	0	0	10	3	8

Source: World Bank Doing Business database, 2004.

The draft labor code relaxes some of the constraints on labor adjustment but still severely over-regulates employment relations. The draft labor code (of Spring 2005) bears the legacy of communist labor relations. It provides detailed regulations of almost every possible aspect of industrial relations and provides for high procedural costs of labor adjustment.[26] For example, the employers would need to notify the relevant trade union of a planned lay-off at least three months prior to its occurrence, discuss with the union possible preventive measures, and carry out the lay-off only in accordance with the trade union's opinion. At the same time the use of fixed-term contracts, which can facilitate labor adjustment, is strictly limited. As such, the draft labor code does not provide regulatory foundations for an adaptable labor market (leaving aside the issue of enforcement). One additional shortcoming of overregulated labor relations is that they impede the development of social dialogue and collective bargaining. If all aspects of labor relations are already regulated by the labor code and the statutory minima are set at a high level, then there is little scope for direct bargaining between employers and trade unions.

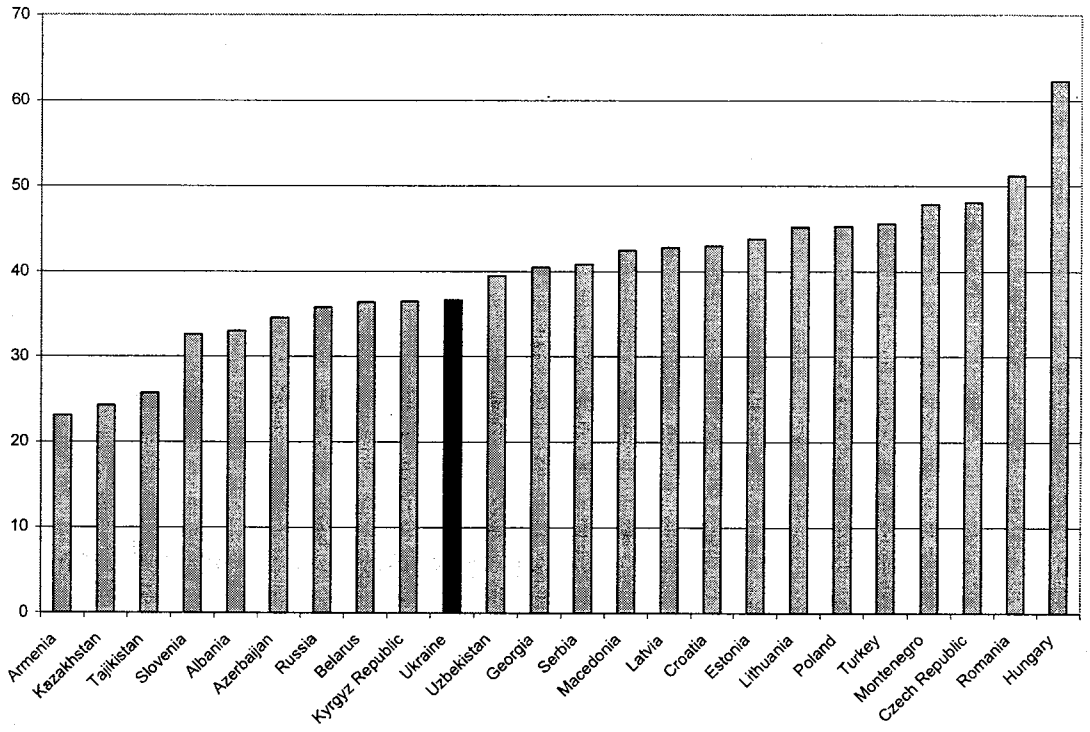
The discrepancy between employers' perceptions and objective indicators of the strictness of EPL is explained by lax or selective enforcement of labor regulation. **But labor market flexibility through non-enforcement is not an optimal outcome.** It undermines the

[26] The monetary cost of dismissal is modest and should not be a subject of concern, as firms should partly internalize social cost of unemployment (Blanchard, 2004).

rule of law, exposes firms to costly uncertainty (circumventing regulations involves costs, especially if enforcement is discretionary and selective) and leaves workers without adequate protection. Unduly strict EPL, even if only weakly enforced, is not conducive to fast and large scale reallocation of labor, which is necessary for the successful transition and productivity growth (World Bank, 2005). A socially superior solution is to deregulate employment relations so as to focus on the effective (as opposed to on paper) protection of key worker rights and standards, while supporting enterprise restructuring and enhancing labor market adaptability.

Taxes on labor are relatively high in Ukraine, although lower than the CEE average. The tax wedge on labor is high in ECA, higher than in most OECD countries, which might negatively affect both labor demand (by raising labor cost) and labor supply (by reducing take-home pay). In Ukraine the tax wedge on labor, at less than 40 percent, is relatively high, although notably lower than in CEE countries, except Slovakia (Figure 15). Payroll taxes in Ukraine are likely to dampen labor demand by raising labor cost (especially given the relatively high minimum wage, which limits the scope for passing the tax onto labor) as well as to reduce labor supply by reducing the take-home pay. Moreover, they are most probably a major factor behind the growth of the informal sector.

Figure 15: Tax wedge on labor: Ukraine against other ECA countries (2003)
The difference between labor cost to the employer and take-home pay as percentage o labor cost



Source: World Bank (2005b).

While the minimum wage is relatively high, lax enforcement means that it has little actual "bite". Experience of other transition economies (e.g. Lithuania, Poland) where the minimum wage equally high (relative to the average wage) as in Ukraine indicates that it may contribute to unemployment among less skilled and less experienced workers, especially in economically depressed regions (Rutkowski 2003b; World Bank, 2001). Notably, this does not appear to be the case in Ukraine where there is evidence of widespread noncompliance with

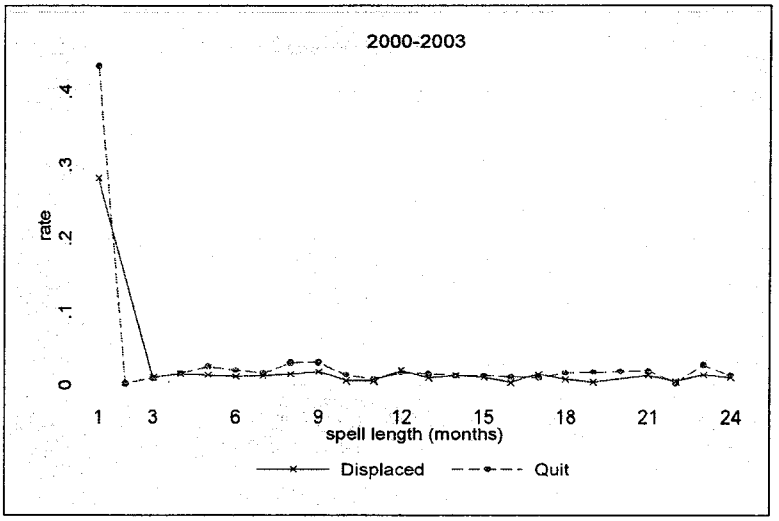
minimum wage regulations (see above): A substantial fraction of workers earns less than the minimum wage. However, this is exactly the argument for lowering the minimum wage: Since it cuts deep into the wage distribution, it would become a binding constraint if effectively enforced and, at its current high level, would lead to a job loss among less productive workers.

The generosity of the unemployment benefits system is modest. Unambiguous assessment of the unemployment benefits in Ukraine is difficult because the system is generous in some aspects (coverage, duration) and less generous in others (replacement rate). The *benefit coverage rate* (percentage of the registered unemployed who receive benefit) at 81 percent in 2003 is very high, compared to 20-30 percent in other transition economies. On the other hand, less than 50 percent of the ILO/LFS unemployed are registered with Employment Offices, suggesting that only those unemployed with eligibility for unemployment benefits register. In other words, the unemployment register does not seem to cover workers who are unemployed and ineligible for benefits. Accordingly, the *effective* coverage rate is much lower (40 percent of the unemployed). The *benefit replacement rate* is relatively low. On average, unemployment benefit accounts for 26 percent of the average wage in the economy, and for 58 percent of the statutory minimum wage.[27] Typical *benefit duration* is one year, which is similar to other European and transition economies. Workers in pre-retirement age (58 years of age for men and 53 for women) can receive the benefit for as long as two years, while new entrants to the labor market (uninsured workers) can receive unemployment benefit for 180 days.

Unemployment benefits seem to have no discernible effect on the outflow rate from unemployment. Estimates of the so called "hazard rates" suggest that unemployment benefits do not create significant adverse labor supply effects (Figure 16). One does not see increased outflows from unemployment to jobs after the exhaustion of benefit entitlement. After all, the vast majority of those who find jobs after displacement (or quit) do so within the first month of non employment. Apparently, unemployment benefit receipt does not prevent displaced workers from actively looking for new employment. In other words, workers do not delay their job search until after unemployment benefits cease. There is thus no evidence that unemployment benefits increase the duration of job search and thereby contribute to unemployment.

[27] But there is some anecdotal evidence (provided by the Ministry of Labor) that unemployment benefits do raise the reservation wages of the unemployed, who reportedly are often not willing to accept low-paid jobs.

Figure 16: Unemployment benefits have no impact on the outflow rate from unemployment
Hazard rates from non-employment



Source: Ukrainian Longitudinal Monitoring Survey, 2002-2003.

Public works and training are the main active labor market programs (ALMP) for the unemployed. About 13 percent of the registered unemployed participated in public works and 6 percent were enrolled in training courses in 2003. In addition, slightly less than one percent was employed in subsidized jobs and close to 2 percent received lump sum grant to start up a business. Little is known of the cost-effectiveness of these programs in Ukraine. Evidence from other transition economies and OECD countries shows that public works should be thought of as an income support scheme rather than as a bridge to regular employment (in fact, the net employment impact of public works is often negative). Training can have a positive net impact if well targeted and tailored to the needs of both employers and the unemployed. Moreover, the efficiency of training closely depends on the availability of job openings. If labor demand is depressed and vacancies are few, training is usually not effective, i.e., it does not improve chances for employment (Betcherman and others, 2004). It is important to realize that while ALMPs may help disadvantaged worker groups (e.g. youth, low skilled workers) find employment, they do not create new jobs nor do they raise overall employment. Thus, the potential of ALMPs in improving labor market conditions is limited (Rutkowski, 2004).

III. THE POLICY CHALLENGE: PROMOTING JOB CREATION IN UKRAINE

Improving the functioning of the labor market is a key challenge facing Ukraine for two reasons. First, the labor market needs to be flexible to support industrial restructuring and long-term economic growth. Second, the labor market needs to work well to ensure employment and earnings growth, and consequently, to raise the standards of living.

The link between labor market performance and the standard of living is of particular importance given the likely acceleration of enterprise restructuring and the attendant increase in unemployment. An increase in unemployment will cause an increase in poverty and will have a bearing on the entire social protection system. On the expenditure side, it will engender pressures on the unemployment benefit and social assistance systems as well as on the pension system through early retirement and disability schemes (retirement and disability pensions are often used as *de facto* substitutes for unemployment benefit). On the revenue side, higher unemployment, coupled with growth in the informal sector, will result in a narrower tax base. This, in turn, will exert pressure on raising tax rates, and higher tax rates will dampen labor demand. In this context, fostering job creation is critical. If the pace of job creation is sufficiently high, then an increase in job destruction associated with structural reforms will lead to an increase in short-term (transient) unemployment, but not necessarily in long-term unemployment, thus limiting the resulting social cost.

In order to create more and better (more productive and higher paying) jobs, Ukraine needs to pursue a two pronged strategy. **First and foremost, it needs to improve the *investment climate* and lower the cost of doing business to encourage entry of and growth by firms.** There is a need to provide adequate incentives for firms to establish and grow in order to expand job creation as well as accelerate absorption of workers displaced by structural changes. "Encouragement" policies such as these are particularly important given that the size of the "new" and job generating sector is still small in Ukraine.

Second, it needs to reform its *labor market institutions* to create an adaptable labor market. This is a market where employers have incentives to hire workers, and workers have incentives and skills to take-up available jobs.[28] Although currently labor market regulations do not seem to be a significant obstacle to firm growth due to lax enforcement, they might become one in the future. Accordingly, revising labor market regulations so as to improve labor market adaptability is necessary to lay the foundation for job creation and productivity growth in the long-term.

The first step toward improving the investment climate is to identify the key constraints to firm entry and growth. They can be identified using specially designed surveys and, more importantly, through regular consultations with the business community. More broadly, genuine social dialogue can facilitate agreements which would balance the interests of employers with those of workers. For such dialogue to be effective, however, there is a need to balance power between all partners, so that no one side will dominate the process.

Based on the results of the BEEPS survey, **the top priorities for investment climate reform in Ukraine are as follows:**

---

[28] This general policy framework was developed in World Bank (2005b).

- *Reducing corruption.* This involves reducing the discretionary power of bureaucrats, simplifying regulations and procedures to reduce scope for arbitrary interpretation and decisions, limiting to a minimum the number of permits, certificates and licenses, and limiting the number and frequency of various inspections.
- *Reducing regulatory and economic policy uncertainty.* By its very nature, transition is associated with uncertainty. Still there is scope for reducing this uncertainty by improving the design of regulations and policies in order to avoid frequent, often erratic changes sometimes introduced under pressure from special interest groups. This involves developing policy analysis, conducting consultations prior to important regulatory and policy changes, and building consensus around reforms.
- *Improving tax administration.* This involves simplifying tax regulations, ensuring their consistent interpretation, cutting red tape, limiting bureaucratic harassment, and controlling tax inspections to curb extortion.
- *Reducing the number of permits and licenses, and simplifying custom and trade regulations.* This should be part of a broader effort to liberalize and deregulate the economy and reduce the extent of state control over business activity. Less cumbersome regulations reduce the cost of operating in the formal sector and thus can entice informal firms to become formal.
- *Improving access to finance.* Access to credit has been proven to be a critical factor affecting firm entry and growth. Key reforms in this area include promoting competition in the banking sector so as to reduce the interest rate spread, and developing micro-finance schemes so as to improve access to finance by small business. Easier access to finance can also improve incentives for firms to register and thus to reduce the size of the informal sector.

Labor market reforms should constitute a package consisting of three major elements: (a) the liberalization of employment relations, (b) the development of direct bargaining between employers and workers, and (c) effective enforcement of core worker rights. In particular:

- *Liberalizing employment protection legislation.* The labor code should regulate a narrower area of employment relations and the regulations should provide for minimum statutory standards of employment protection so as to create room for direct bargaining between social partners. In particular, the procedural *costs of dismissals* should be reduced to facilitate employment adjustment. Provisions governing *flexible employment contracts* (e.g. fixed term contracts) should be liberalized so as to lower labor adjustment cost and encourage hiring. *Working time flexibility* should be enhanced by liberalizing rules governing overtime work, and permitting the redistribution of the working hours over a longer period of time to facilitate adjustment to seasonal demand fluctuations.
- *Developing efficient bargaining structures.* The collective bargaining system in Ukraine needs to develop so as to meet the criteria for efficiency (see Box 1.2). Particularly, the interests of employers need to be better balanced with those of employees. Collective agreements concluded with the state acting as an employer will need to be renegotiated to be applied to the private sector. Moreover, the efficiency of industry level bargaining needs to be reassessed. Industry level bargaining can be inefficient since the agreements take into account neither firm specific conditions nor economy-wide effects of wage increases. Therefore such agreements should include opt-out options for firms which cannot afford to comply. An alternative is to move away from industry level bargaining toward more efficient firm level bargaining. Firm level bargaining takes into account firm specific conditions as well as the effects of the agreement on the firm's

competitiveness. However, a move toward firm level bargaining assumes that worker interests are adequately represented at the firm level.

- *Improving the enforcement capacity of labor inspections.* While the employment protection legislation should be significantly liberalized and employment relations should be deregulated, the core worker rights should be effectively protected. Firms need to comply with labor regulations to respect the rule of law, and to provide workers with socially acceptable and economically efficient degree of employment protection. But rather than increasing the already high burden of inspections on firms, or increasing the penalties, new modes of inspection services, such as self-reporting or contracting-out, should be tested.

- *Reviewing the minimum wage policy so as to take into account labor market conditions and unemployment among affected workers.* Currently the minimum wage is high *relative to* the average wage, but not enforced.[29] Enforcement, however, could cause job loss among less productive workers (youth, unskilled workers). Therefore the government can consider setting minimum wage at a lower proportion of the average wage (e.g. one-third of the average wage) to limit its potential dis-employment effect. This can be coupled with setting a separate (higher) minimum base for social insurance contribution to protect social budget revenues. Alternatively, a youth sub-minimum (e.g. 80 percent of the regular minimum) could be instituted to protect employment among the most vulnerable group. In addition, social benefits should be de-linked from the minimum wage to render the minimum wage policy independent of other social policies. However, it is important that the minimum wage policy is based on reliable data on the wage distribution and the correct estimate of the average wage is available.

- *Reducing payroll taxes.* This involves broadening the tax base through providing incentives for firms to move to the formal sector (see above), and improving the cost-effectiveness of social expenditures which are financed by payroll-taxes (mainly pensions). However, this is a gradual process closely associated with reforming the social insurance system.

- *Putting in place the system of monitoring and evaluation of active labor market programs (ALMP).* ALMP can be a useful too for improving employment chances of disadvantaged worker groups. However, they do not increase overall employment. Evidence shows that their *net* impact is limited. At the same time they are costly. Therefore it is important to improve the cost-effectiveness and targeting efficiency of the programs. To this end, net impact and cost per placement need to be determined for various client groups and under different labor market conditions so as to target programs at groups that benefit most from a given intervention.

Labor reforms are politically difficult because they involve trade-offs between interests of various groups: insiders (workers with secure jobs) and outsiders (workers with insecure jobs or the jobless) as well as employers. For example, reforms which limit employment protection weaken the position of those with jobs, but improve the employment chances of the unemployed, and at the same time give employers more flexibility in adapting to changing product demand conditions.

---

[29] This assessment is based on the assumption that the official estimates of the average are correct. If however, as sometimes asserted, wages are significantly underreported then the minimum wage to average wage ratio is overestimated and accordingly the "bite" of the minimum wage is less. Therefore for a sound minimum wage policy better data on the wage distribution and further research are necessary to determine the actual amount of the average wage and the minimum wage-to-average wage ratio.

The recent examples of labor market reforms in countries such as Croatia, Poland, Serbia and Montenegro, and Slovakia demonstrate that they can be successfully carried through. The conditions for success include having an agent of change (a government unit, an employer organization, a progressive trade union), an effective dialogue between genuine representation of social partners, and finally a well designed public information campaign to inform the key stakeholders of the costs of existing provisions and the benefits of reforms.

Eventually, reforms need to balance interests of all sides. In the Ukrainian context, the *quid pro quo* consists of deregulating employment relations but improving the enforcement of core worker rights also in the private sector, where unions are weaker.

ANNEX 1
COMPARATIVE DATA ON THE PROGRESS OF TRANSITION AND ON LABOR MARKETS

Table A1.1 Progress of structural reforms: Ukraine against its neighbors, 2004

	Poland	Romania	Russia	Slovakia	Ukraine
Privatization					
Private sector share in GDP (%)	75.0	70.0	70.0	80.0	65.0
Private sector share in employment (%)	72 [a)]	75.0	na	75 [b)]	42 [c)]
EBRD index of small-scale privatization	4.3	3.7	4.0	4.3	4.0
EBRD index of large-scale privatization	3.3	3.7	3.3	4.0	3.0
Enterprise and markets					
EBRD index of enterprise reform	3.3	2.0	2.3	3.0	2.0
EBRD index of competition policy	3.0	2.3	2.3	3.0	2.3
Financial sector					
EBRD index of banking sector reform	3.3	2.7	2.0	3.7	2.3
Memorandum items					
GDP per capita (in US dollars) a)	5402	2624	2987	6045	1024
Agriculture, value added (% of GDP) [a)]	3.1	11.9	5.2	3.7	14.1

a) 2003
b) 2001
c) ULMS

Source: EBRD (2004), Transition report, London; World Development Indicators database 2005.

Table A1.2 Key labor market indicators: Ukraine against the OECD, 2004
(percentages)

	Ukraine	EU-15	OECD	OECD CEE	United Kingdom	Czech Republic
Employment-to-population ratio	56.7	65	65.3	57.5	72.7	64.2
Labor force participation rate	62.0	70.8	70.1	66.1	76.2	70.1
Unemployment rate	8.6	8.2	6.9	13	4.7	8.4
Incidence of long-term unemployment	42.5	42.4	32	51.4	21.4	51.8

Notes:
Persons aged 15-70 for Ukraine and 15-64 for other countries
OECD CEE: Czech Republic, Hungary, Poland and Slovakia.
Long-term unemployed: persons unemployed for 12 months and over
The United Kingdom and the Czech Republic were selected as examples of well-performing labor markets in Western Europe and in Central Europe, respectively.

Sources:
OECD: Employment Outlook, 2005
Ukraine: www.ukrstat.gov.ua

ANNEX 2
RESULTS OF THE REGRESSION ANALYSIS OF FIRM LEVEL EMPLOYMENT GROWTH

TableA2.1: The determinants of firm-level employment growth in industry (manufacturing and mining) during 2002-2003

Dependent variable: employment growth rate

Explanatory variables	Regression equations			
	(1)		(2)	
ln(size)	0.007	(0.005)	-0.006	(0.006)
ln(labor productivity)	-		0.055*	(0.008)
Ownership form (State)				
Liability company	0.097*	(0.024)	0.050*	(0.023)
Joint-stock company	-0.008	(0.016)	-0.020	(0.015)
Private enterprise	0.094*	(0.044)	0.052	(0.045)
Other types of ownership	0.000	(0.024)	-0.004	(0.024)
Industrial sector (Energy industry)				
Fuel industry	-0.095*	(0.024)	-0.068*	(0.022)
Ferrous metallurgy	-0.009	(0.024)	-0.005	(0.027)
Machine building and metals industry	-0.080*	(0.019)	-0.028	(0.022)
Non-ferrous metallurgy	-0.085*	(0.043)	-0.073	(0.038)
Chemical and petrochemical industry	-0.072*	(0.033)	-0.069*	(0.031)
Wood and paper industry	-0.123*	(0.030)	-0.086*	(0.031)
Construction materials industry	-0.006	(0.024)	0.014	(0.026)
Glass and pottery, china industry	-0.107	(0.066)	-0.066	(0.064)
Light industry	-0.141	(0.026)	-0.069*	(0.028)
Food processing industry	-0.059*	(0.019)	-0.063*	(0.021)
Microbiological industry	-0.147*	(0.026)	-0.157*	(0.031)
Bakery, serial and feedstuff industry	-0.081*	(0.036)	-0.046	(0.036)
Medical industry	-0.024	(0.026)	-0.042	(0.032)
Printing industry	-0.084*	(0.032)	-0.075	(0.033)
Other branches of industry	-0.027	(0.037)	-0.016	(0.040)
Type of region (Agricultural)				
Heavily industrialized region	0.039*	(0.017)	0.028	(0.017)
With diversified economy	0.018	(0.015)	0.003	(0.015)
Constant	-0.038	(0.039)	-0.129*	(0.039
Number of observations	2052		2009	
R-squared	0.040		0.081	

Note: Dependent variable is gremp=2(empl2003-empl2002)/ (empl2003+empl2002). Labor productivity is defined as value of sales in 2002 divided by the total number of workers in the end of 2002. Reference (omitted) categories are indicated in parentheses. Robust standard errors are in brackets.

*Indicates 5% significance level.
Source: Ukrainian Labor Market Flexibility Survey. Bank staff calculations.

ANNEX 3
RESULTS OF THE REGRESSION ANALYSIS OF WAGE DETERMINATION

TableA3.1: The determinants of earnings of formal sector workers, 2004

Dependent variable: log monthly earnings

Variable	Coefficient	t-statistics	Significance
Education [a]			
Vocational training	0.033	0.5	
Secondary	0.134	2.2	*
College	0.258	4.3	**
University	0.493	7.9	**
Age	0.016	2.8	**
Age squared/100	0.022	-3.4	**
Female	-0.303	-13.7	**
Collective agreement	0.101	2.9	**
Regional dummies	yes		Significant
Industry dummies	yes		Significant
Constant	5.193	37.7	**
Number of obs.	2125		
F-statistics	23.54		
R-squared	0.332		
Adj. R-squared	0.318		

** indicates 1% significance level

* indicates 5% significance level

a) Primary education is the reference category)

Source: Ukrainian Longitudinal Monitoring Survey, 2004

ANNEX 4
THE UKRAINIAN LONGITUDINAL MONITORING SURVEY (ULMS)

The Ukrainian Longitudinal Monitoring Survey (ULMS), started in 2003, is a household panel, and was established to monitor the Ukraine's path of transition from Communism to a market-oriented social democracy. Thus far two waves of data have been collected, in March to June of 2003, and May to August of 2004. Access to the micro data is for the moment available only at the IZA-Bonn and the RWI-Essen. The data of the first wave consist of more than 8600 respondents, comparable to the initial samples of the American Panel Study of Income Dynamics (PSID), German Socio-Economic Panel (SOEP), the British Household Panel Studs (BHPS) and the Russian Longitudinal Monitoring Survey (RLMS).

Sample

The ULMS sample is collected by the Kiev International Institute of Sociology (KIIS). The sample is drawn from the December 2001 Ukrainian Census and stratified by age, gender, city/town, and regional structure. The target of the household survey is the working age population. In the original ULMS sample in 2003, the definition of the working-age population comprises of persons between the ages of 15 and 72, who then were administered the individual questionnaire. An additional household questionnaire was administered with the household head (that person most knowledgeable of household matters) responding.
The starting ULMS sample is representative for the working-age population of Ukraine in 2003, with 8641 individuals in 4056 households. The part of that sample (1453 individual interviews, 841 households) was panel, using the sample of the 1995-96 surveys undertaken by KIIS. In each household with persons between the ages of 15 and 72, the household questionnaire was administered. Afterwards, the individual questionnaires were administered to all persons between the ages of 15 and 72. The fieldwork in 2003 lasted 3 months and was carried out by 160 interviewers. See KIIS (2003) for a detailed description of the sample definition.
KIIS (2003) report an initial household response rate of 66% for the ULMS. The wave 1 to wave 2 attrition was in the order of 20%.

Survey Instruments

The original questionnaires are available in English, Russian and Ukrainian. As in many household panel surveys, there are different reference periods addressed in the instruments: (i) retrospective information, where information is gathered about employment changes in 1986, 1991, 1997, 1998–2002 and about changes of residence since 1986, and (ii) concerning the reference-week, where information is gathered about the week preceding the interview. Further, detailed individual characteristics of household members are collected, along with educational attainment and skills section, and finishing with attitudes, health, and ecology issues.
The detail and depth of the ULMS data is similar to that of the well-know German Socio-Economic Panel (GSOEP) and the British Household Panel (BHPS). The first wave of the ULMS, based on the individual questionnaire, includes 1837 variables with an additional 679 variables in the life history chart. The data file based on the household questionnaire includes 240 variables. The average survey duration of the individual survey is 72 minutes and 22 for the household survey.

There are some particularly interesting aspects to the questionnaires. There is particular depth of information with respect to the respondent's own educational attainment and that of his parents. The retrospective questions concerning labor market activity are asked 1986 and 1991. Starting for the year 1997, a complete employment history is recreated up to the date of the

interview in 2003. Indeed they are so complete that hazard rate models can be estimated on labor market. This is unusual as many household panels only collect current month information on employment.
As informal activity in the underground economy also plays an important role in the Ukraine, contingent employment and informal employment is explicitly captured with the survey instrument. During transition to the market economy, there are many large changes in the industrial structure observed in the post-Soviet countries. The questionnaires allow the researcher to observe whether the employee has been simply displaced as opposed to fired (for cause). Together with the identification of informal employment activity, a clearer picture can be taken of the household responses at the micro level.

References

Kiev International Institute of Sociology (2003), Ukrainian Longitudinal Monitoring Survey 2003, Technical Report, Kiev Ukraine, mimeo.

Lehmann, H. and Haisken-Denew, J.(2004), The Ukrainian Longitudinal Monitoring Survey (ULMS): An Overview, Bologna and Essen, mimeo.

REFERENCES

Betcherman, G., A. Luinstra and M. Ogawa (2001), "Labor market regulation: International experience in promoting employment and social protection", SP Discussion Paper, No. 0128

Betcherman, Gordon, Karina Olivas and Amit Dar (2004), "Impacts of active labor market programs : new evidence from evaluations with particular attention to developing and transition countries", Social Protection discussion paper series, no. 0402.

Blanchard, Oliver (2004), "Reforming Labor Market Institutions: Unemployment Insurance and Employment Protection", Massachusetts Institute of Technology, Department of Economics Working Paper Series, Working Paper 04-38.

Brown, David and John Earle (2004), Job Reallocation and Productivity Growth in the Ukrainian Transition, IZA Discussion Paper NO. 1349, Bonn.

Boeri, Tito and Katherine Terrell (2002), Institutional Determinants of Labor Reallocation in Transition, Journal of Economic Perspectives, Vol. 16, No. 1. (Winter)

Derzhkomstat (2005), Economic activity of the population of Ukraine 2004, Kiyv 2005.

Gorodnichenko, Y. and Sabirianova, K. (2004), Returns to Schooling in Russia and Ukraine: A Semiparametric Approach to Cross-Country Comparative Analysis, IZA Discussion Paper No. 1325, Bonn.

Khan, Azfar and Laszlo Zsoldos (2005), "Has Enterprise Restructuring Weakened Workers' Security? Findings from the ULFS 1994 – 2004", Photocopy, ILO, Geneva.

Konings, J., Kupets, O. and Lehmann, H. (2003), Gross Job Flows in Ukraine: Size, Ownership and Trade Effects, Economics of Transition 11 (2), 321-356.

Lehmann, Hartmut, Olga Kupets and Norberto Pignatti (2005), Labor Market Adjustment in Ukraine: An Overview. Background paper prepared for the World Bank Ukraine Jobs Study.

O'Keefe, Philip (2004), Labor Market Institutions and Policies in ECA, World Bank, mimeo.

Rutkowski, Jan (1996), "High Skills Pay-off: the Changing Wage Structure during Economic Transition in Poland", Economics of Transition, 4(1), 89-112.

Rutkowski, Jan (2003a), "Minimum Wage: Curse or Cure?", Photocopy, World Bank, Washington, D.C.

Rutkowski, Jan (2003b), "Rapid Labor Reallocation with a Stagnant Unemployment Pool: The Puzzle of the Labor Market in Lithuania", Policy Research Working Paper No. 2946, World Bank, Washington, DC.

Rutkowski, Jan (2004), "Labor Market Interventions during the Transition in ECA", Spectrum, Summer.

Schneider, Friedrich (2005), Shadow Economies of 145 Countries all over the World: Estimation Results over the Period 1999 to 2003, Photocopy, Johannes Kepler University, Linz.

World Bank (2001), Poland Labor Market Study – The Challenge of Job Creation, Washington, D.C.

World Bank (2003), "Ukraine: Improving Safety Nets and Labor Market Policies to Reduce Poverty and Vulnerability", Washington, DC..

World Bank (2004), Ukraine: Building Foundations for Sustainable Growth. Country Economic Memorandum, Washington, DC.

World Bank (2005) Ukraine: Poverty, Growth and Labor Markets in a Growing Economy 1999-2003. Volume 1 produced under the PULSE activities.

World Bank (2005b), Enhancing Job Opportunities: Eastern Europe and the Former Soviet Union. Washington, D.C.

EXHIBIT 3

Archives: 2005| 2004 | 2003

Wage arrears by region, 2005

(as of month 1-st, mln.UAH)

	January	February	March	April	May	June	July	August	September	October	November	December
Ukraine	**1111,2**	**1225,9**	**1282,6**	**1295,4**	**1254,0**	**1301,7**	**1341,3**	**1287,8**	**1091,1**	**1092,5**	**1121,4**	**1113,4**
Autonomous Republic of Crimea	43,0	47,1	49,1	50,4	49,1	54,1	52,1	49,0	45,5	46,6	47,3	51,7
oblasts												
Vinnytsya	47,1	52,7	58,5	64,9	66,9	72,3	73,4	70,7	58,8	53,7	55,5	54,9
Volyn	9,9	12,6	12,5	14,4	13,0	14,0	13,7	15,6	9,3	9,0	9,5	8,9
Dnipropetrovsk	82,0	84,5	85,5	84,8	75,6	78,6	82,5	79,5	79,4	76,7	72,6	71,7
Donetsk	282,6	305,0	314,4	305,2	292,7	304,8	330,2	321,1	222,7	243,9	272,9	267,6
Zhytomyr	39,3	42,3	44,7	44,0	43,4	45,7	46,3	44,6	43,6	41,2	41,4	40,3
Zakarpattya	2,1	3,5	3,6	3,2	3,2	3,2	2,7	2,7	2,7	2,3	2,4	2,2
Zaporizhya	35,7	38,2	39,7	40,6	38,8	37,9	39,6	37,0	36,2	34,8	36,9	34,5
Ivano-Frankivsk	12,4	13,0	12,6	11,9	11,6	11,7	11,9	11,5	11,2	10,7	9,7	8,8
Kyiv	37,2	41,4	43,2	42,7	41,3	42,3	42,2	42,7	39,2	36,3	35,5	35,6
Kirovohrad	24,1	28,1	29,6	31,7	32,7	35,0	34,8	35,1	34,7	34,9	34,9	37,1
Luhansk	114,3	121,5	127,3	128,9	125,3	132,7	138,9	133,3	105,5	105,2	110,4	106,0
Lviv	41,4	46,3	45,9	48,8	45,6	47,9	50,7	47,9	39,4	40,1	40,0	39,6
Mykolayiv	23,5	26,1	27,2	30,9	27,1	26,8	26,1	24,6	23,7	23,8	22,4	23,4
Odesa	21,2	23,6	30,4	29,8	32,2	35,2	36,7	34,9	34,5	34,7	34,7	35,2
Poltava	26,6	31,1	32,0	33,7	32,2	33,1	32,8	28,4	27,0	25,4	29,0	26,9
Rivne	8,8	10,7	11,5	11,6	12,2	13,2	14,4	13,1	12,1	12,3	14,4	15,1
Sumy	31,7	38,5	41,5	40,5	40,2	43,7	43,6	40,6	37,5	38,7	36,9	39,3
Ternopil	26,9	32,3	32,9	34,3	33,3	33,8	33,5	33,4	31,9	31,4	30,5	29,6
Kharkiv	36,4	48,0	48,0	48,9	45,0	48,7	48,6	47,3	35,3	36,3	34,3	35,0
Kherson	42,0	40,0	40,2	38,9	37,6	33,8	33,8	30,5	28,4	25,1	23,2	23,2
Khmelnytskiy	63,3	69,2	70,9	72,9	72,8	69,0	69,0	64,0	58,4	56,0	55,3	54,5
Cherkasy	25,9	32,3	39,5	41,5	42,2	42,2	40,1	37,5	34,3	33,2	33,4	31,5
Chernivtsi	5,8	6,5	6,8	6,1	6,1	6,0	6,9	7,5	6,3	6,1	6,7	7,2
Chernihiv	14,5	18,5	19,4	19,6	19,7	21,3	20,9	19,6	18,3	18,5	16,4	16,4
City of Kyiv	8,9	6,8	9,7	9,6	9,4	9,7	10,1	9,2	8,6	8,1	7,4	8,6
City of Sevastopol	4,6	6,1	6,0	5,6	4,8	5,0	5,8	6,5	6,6	7,5	7,8	8,6

Footnote. Since January 2005, the total amount of arrears of wages includes data from economically active enterprises and entities which undergo the procedures regarding the resumption of debtor's ability to pay or a debtor being declared bankrupt. This also incorporates data from economically inactive enterprises.

Date of the Last modifications: 27/12/2005

EXHIBIT 4

Doing Business

Benchmarking Business Regulations

Doing Business Home > Explore Economies

Explore Economies

This page provides a snapshot of each economy's aggregate ranking on the ease of doing business and on each of the ten topics that comprise the overall ranking. Data is also provided for each country for all the 10 topics covered in the database.

Classifications

View how economies are classified in terms of income per capita, the informal sector, and location.

Methodology

Symbols

.. means "not available"
— means "not applicable"

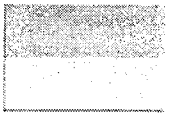
Generate economy snapshot

See a business environment summary: select an economy

Featured snapshot report

Ukraine

Region: Europe & Central Asia
Income category: Lower middle income
Population*: 48.4 million
GNI per capita (US$)*: 1,260
Informal economy estimate (% GNP)*: 52.2



* Please see the Economy Characteristics methodology for information on sources.

Ease of...	Economy rank	Best performer	Worst Performer
Doing Business	*124*	*New Zealand*	*Congo, Dem. Rep.*
Starting a Business	110	Canada	Angola
Dealing with Licenses	98	Palau	Tanzania
Hiring and Firing	119	Palau	Burkina Faso
Registering Property	127	New Zealand	Nigeria
Getting Credit	75	United Kingdom	Cambodia
Protecting Investors	141	New Zealand	Afghanistan
Paying Taxes	151	Maldives	Belarus
Trading Across Borders	78	Denmark	Iraq
Enforcing Contracts	39	Norway	Timor-Leste
Closing a Business	123	Japan	West Bank and Gaza

Compare All Economies

Starting a Business (2005)

The challenges of launching a business in Ukraine are shown below. Entrepreneurs can expect to go through **15** steps to launch a business over **34** days on average, at a cost equal to **10.6%** of gross national income (GNI) per capita. They must deposit at least **183.0%** of GNI per capita in a bank to obtain a business registration number.

Indicator	Ukraine	Region	OECD
Procedures (number)	15	9.7	6.5
Time (days)	34	36.5	19.5
Cost (% of income per capita)	10.6	13.5	6.8

Min. capital (% of income per capita)	183.0	49.1	41.0

Details | Compare All Economies

Dealing with Licenses (2005)

The steps, time, and costs of complying with licensing and permit requirements for ongoing operations in Ukraine are shown below. It takes **18** steps and **265** days to complete the process, and costs **229.4%** of income per capita.

Indicator	Ukraine	Region	OECD
Procedures (number)	18	21.4	14.1
Time (days)	265	251.8	146.9
Cost (% of income per capita)	229.4	668.9	75.1

Compare All Economies

Hiring & Firing Workers (2005)

The difficulties that employers in Ukraine face in hiring and firing workers are shown below. Each index assigns values between 0 and 100, with higher values representing more rigid regulations. The Rigidity of Employment Index is an average of the three indices. For Ukraine, the overall index is **61**.

Indicator	Ukraine	Region	OECD
Difficulty of Hiring Index	44	34.5	30.1
Rigidity of Hours Index	60	56.9	50.4
Difficulty of Firing Index	80	41.5	27.4
Rigidity of Employment Index	61	44.3	36.1
Hiring cost (% of salary)	36.4	29.6	20.7
Firing costs (weeks of wages)	16.6	32.8	35.1

Compare All Economies

Registering Property (2005)

The ease with which businesses can secure rights to property is measured below. In Ukraine, it takes **10** steps and **93** days to register property. The cost to register property there is **3.8%** of overall property value.

Indicator	Ukraine	Region	OECD
Procedures (number)	10	6.5	4.7
Time (days)	93	127.1	32.2
Cost (% of property value)	3.8	3.0	4.8

Details (PDF) | Compare All Economies

Getting Credit (2005)

Measures on credit information sharing and the legal rights of borrowers and lenders in Ukraine are shown below. The Legal Rights Index ranges from 0-10, with higher scores indicating that those laws are better designed to expand access to credit. The Credit Information Index measures the scope, access and quality of credit information available through public registries or private bureaus. It ranges from 0-6, with higher values indicating that more credit information is available from a public registry or private bureau.

Indicator	Ukraine	Region	OECD
Legal Rights Index	8	5.6	6.3

Credit Information Index	0	2.5	5.0
Public registry coverage (% adults)	0.0	1.4	7.5
Private bureau coverage (% adults)	0.0	6.6	59.0

Compare All Economies

Protecting Investors (2005)

The indicators below describe three dimensions of investor protection: transparency of transactions (Extent of Disclosure Index), liability for self-dealing (Extent of Director Liability Index), shareholders' ability to sue officers and directors for misconduct (Ease of Shareholder Suits Index) and Strength of Investor Protection Index. The indexes vary between 0 and 10, with higher values indicating greater disclosure, greater liability of directors, greater powers of shareholders to challenge the transaction, and better investor protection.

Indicator	Ukraine	Region	OECD
Disclosure Index	1	4.5	6.1
Director Liability Index	3	4.3	5.1
Shareholder Suits Index	4	5.6	6.6
Investor Protection Index	2.7	4.8	5.9

Compare All Economies

Paying Taxes (2005)

The effective tax that a medium size company in Ukraine must pay or withhold within a year is shown below. Entrepreneurs there must make **84** payments, spend **2,185** hours, and pay **51.0%** of gross profit in taxes.

Indicator	Ukraine	Region	OECD
Payments (number)	84	46.9	16.9
Time (hours)	2,185	431.5	197.2
Total tax payable (% gross profit)	51.0	50.2	45.4

Compare All Economies

Trading Across Borders (2005)

The costs and procedures involved in importing and exporting a standardized shipment of goods in Ukraine are detailed under this topic. Every official procedure involved is recorded - starting from the final contractual agreement between the two parties, and ending with the delivery of the goods.

Indicator	Ukraine	Region	OECD
Documents for export (number)	6	7.7	5.3
Signatures for export (number)	9	10.9	3.2
Time for export (days)	34	31.6	12.6
Documents for import (number)	10	11.7	6.9
Signatures for import (number)	10	15.0	3.3
Time for import (days)	46	43.0	14.0

Compare All Economies

Enforcing Contracts (2005)

The ease or difficulty of enforcing commercial contracts in Ukraine is measured below. It takes **28** steps and **269** days to enforce

contracts there. The cost of enforcing contracts is **11.0%** of debt.

Indicator	Ukraine	Region	OECD
Procedures (number)	28	..	17.4
Time (days)	269	..	29.6
Cost (% of debt)	11.0	..	..

Compare All Economies

Closing a Business (2005)

The time and cost required to resolve bankruptcies is shown below. In Ukraine, the process takes **2.9** years and costs **42%** of the estate value. The recovery rate, expressed in terms of how many cents on the dollar claimants recover from the insolvent firm, is **8.45**.

Indicator	Ukraine	Region	OECD
Time (years)	2.9	3.5	1.5
Cost (% of estate)	42	14.0	7.4
Recovery rate (cents on the dollar)	8.5	29.8	73.8

Compare All Economies

EXHIBIT 5

TRANSPARENCY INTERNATIONAL

Report

on the

Transparency International Global Corruption Barometer 2005

Embargoed until 9 December 2005

Release date: 9 December 2005

Policy and Research Department
Transparency International – International Secretariat
Alt Moabit 96
10559 Berlin, Germany
Tel: + 49-30-3438200
Fax: +49-30-34703912

Global Corruption Barometer 2005
Report

Table of contents

About the survey

Transparency International's (TI) Global Corruption Barometer (the Barometer) presents the results of a public opinion survey of about 55,000 people in 69 low, middle, and high-income countries. The survey was carried out by Gallup International, on behalf of TI, from May until October 2005. The Barometer seeks to understand how and in what ways corruption affects ordinary people's lives, providing an indication of the form and extent of corruption from the view of citizens around the world.

The Barometer asks people about their opinions regarding which sectors of society are the most corrupt, which spheres of life are most affected, whether corruption has increased or decreased in relation to the past, and whether it is likely to be more or less prevalent in future. Furthermore, the Barometer explores bribery in depth, and presents information on: how frequently families pay bribes; how these payments take place; whether they are paid to gain access to public services; and how much they pay.

Such information can be vital for helping combat corruption and bribery. For example, establishing how corrupt transactions take place can be important for the design of anti-corruption measures. In addition, by asking the public to specify which sectors of society are most affected by corruption, the Barometer can be a catalyst for reform. Importantly, people's perceptions of the prevalence of corruption over time can be an important measure of the success of anti-corruption policies and initiatives.

The Global Corruption Barometer is one of TI's tools for measuring corruption internationally. Through its focus on public opinion, the Barometer complements the Corruption Perceptions Index and Bribe Payers Index, which are based on the opinions of experts and business leaders. First carried out in 2003 in 45 countries, and then again in 2004 in 64 countries, the Barometer now encompasses almost 70 countries - including previously uncovered nations such as Cambodia, Chile, Ethiopia, Paraguay, Senegal, Serbia, Thailand and Ukraine.

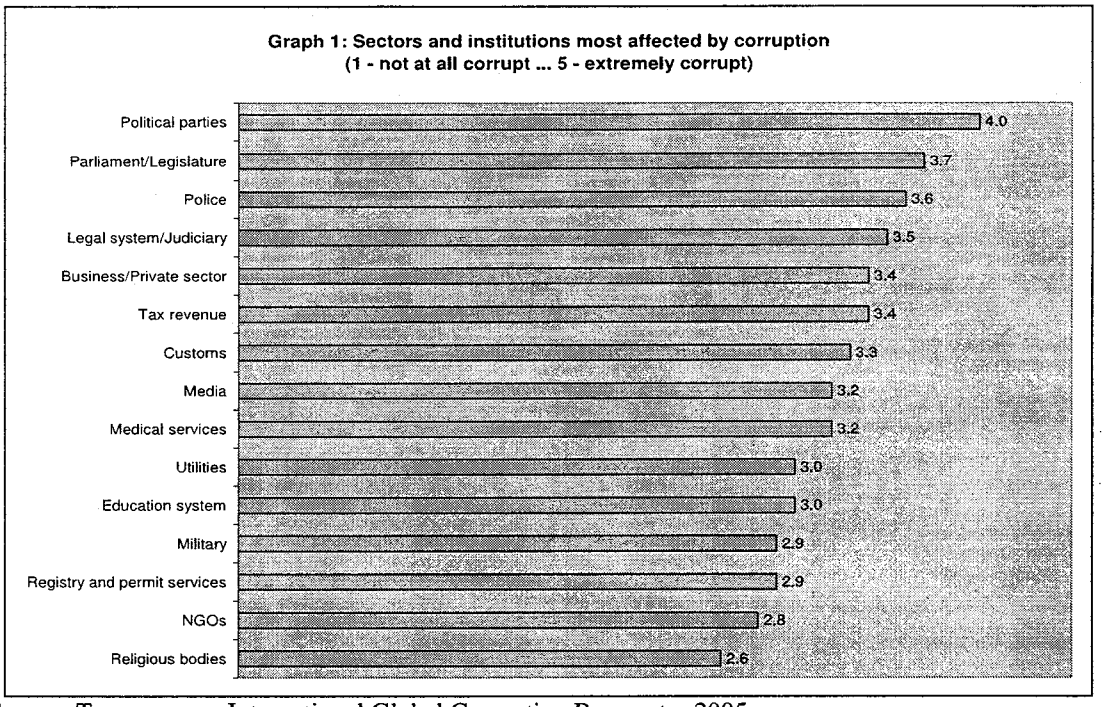
For the full results as well as technical information on the Barometer, such as the survey questionnaire and methodology, and, countries included in the survey, please consult the annexes at the end of the document.

This report has been prepared by Francis Hutchinson, Tom Lavers and Marie Wolkers from the Policy and Research Department at Transparency International Secretariat. For further details please contact Marie Wolkers mwolkers@transparency.org

Which sectors and institutions are most affected by corruption?

The findings of the 2005 Global Corruption Barometer are an indictment of political and justice systems around the world. Citizens in the countries surveyed ranked political parties, parliaments, the police, and the judiciary as the most corrupt institutions in their societies (Graph 1 and Table 9 Annex 1 for the full country results).

Graph 1: Sectors and institutions most affected by corruption



Source: Transparency International Global Corruption Barometer 2005

Political parties were perceived as far and away the most corrupt institutions in society in aggregate terms. In 45 out of the 69 countries[1] surveyed, political parties were ranked as the institution most affected by corruption (Table 1). This is an increase from last year's results, where 36 out of 62 countries listed their party systems as the most corrupt institution.

Citizens in high and middle income countries called their political party systems into question. Among high income countries, citizens from France, Italy, Greece, Japan, Israel, and Taiwan had serious doubts about the integrity of their political parties. Respondents from upper middle-income countries such as Mexico, Panama, Argentina, and Costa Rica, as well as those from lower middle-income countries such as Bolivia, Ecuador, and Paraguay indicated similar concerns.

However, the public in ten out of the 12 low income countries covered by the survey ranked other sectors such as the **police** and **customs** as more corrupt than parties. For

[1] The term countries refers to countries or territories.

example, in Ghana and Cameroon, the police was perceived as much more corrupt than political parties.

Table 1: Countries where political parties are the most corrupt institutions

Country income groups[2]	POLITICAL PARTIES identified as the sector most affected by corruption in the following countries/territories:
High-income countries	Austria, Canada, Finland, France, Germany, Greece, Iceland, Ireland, Israel, Italy, Japan, Luxembourg, Portugal, South Korea*, Spain, Switzerland, United Kingdom, USA
Upper-middle-income countries	Argentina, Chile, Costa Rica, Croatia, Czech Republic*, Lithuania, Mexico*, Panama*, Poland, South Africa*, Uruguay*, Venezuela*
Lower-middle-income countries	Bolivia, Bosnia and Herzegovina, Colombia, Dominican Republic*, Ecuador*, Guatemala*, Indonesia, Paraguay, Peru*, Philippines*, Romania*, Serbia*, Thailand
Low-income countries	India*, Nicaragua

Source: Transparency International Global Corruption Barometer 2005

Looking at the ranking of sectors by regions shows some interesting results (Table 2). Asian, Western European, and Latin American countries listed their **political parties** as the most corrupt institutions. Citizens in these regions also ranked parliament and the legislature as the second-most corrupt institutions, indicating concerns about endemic corruption in their political systems.

However, respondents in Africa and Central and Eastern Europe have different concerns. Six out of the eight participating African countries signalled the **police** as their most corrupt institution. Eleven out of the 14 Central and Eastern European countries also indicated grave concerns about the integrity of the police. This finding was echoed by a smaller group of Latin American and Asian countries.

Concerns about the law and order sector are not limited to the police, but extend to the **legal system** and **judiciary**. Citizens across Central and Eastern Europe and Latin America ranked this institution as one of the three most corrupt in their countries, and the public in Cambodia, Macedonia, Peru*, and Ukraine* specifically pointed to their legal and judicial systems as the most corrupt institutions.

Regarding the more traditional government institutions, respondents listed the **taxation authorities** as constituting the gravest cause for concern. While only Ethiopia* and Turkey rate their taxation agencies as the most corrupt, the public in a range of Asian and Latin American countries indicated significant levels of concern regarding this institution.

[2] Source: The World Bank - http://web.worldbank.org/WBSITE/EXTERNAL/DATASTATISTICS/0,,contentMDK:20421402~menuPK:64133156~pagePK:64133150~piPK:64133175~theSitePK:239419,00.html#lincome

* In the countries marked with an * the sectors mentioned are tied with others as the most corrupt.

However, corruption also extends into the business world, as seen by the comparatively poor overall ranking of the private sector. Indeed, the **private sector** is seen as one of the three most corrupt institutions in Western Europe. Citizens from Denmark*, the Netherlands* and Norway, as well as those from Hong Kong, Singapore, and Ethiopia* signalled business groups and the private sector as institutions that are most affected by corruption.

The **media** received an average overall ranking at the aggregate level, although it was listed as a cause for concern by Western European countries in general. Denmark* and the Netherlands* signalled that the media, along with their private sectors, were the most prone to corruption – perhaps indicating a systemic link between the two.

Table 2: The most corrupt sectors by region[3]

ASIA (12 countries)	Political parties 4.2	Parliament / Legislature 3.9	Police 3.9	Tax Revenue 3.5
AFRICA (8 countries)	Police 4.4	Political parties 4.2	Customs 4.0	Parliament / Legislature 3.8
W.EUROPE (16 countries)	Political parties 3.7	Parliament / Legislature 3.3	Business / private sector 3.3	Media 3.3
C.E.EUROPE (14 countries)	Political parties 4.0	Police 4.0	Parliament / Legislature 3.9	Legal system / Judiciary 3.9
LAC (15 countries)	Political parties 4.5	Parliament / Legislature 4.4	Police 4.3	Legal system / Judiciary 4.3

Customs were a particular area of concern in Africa and Central and Eastern Europe. While only the public in Togo listed customs as the most corrupt sector, other African countries consistently indicated serious doubts about the integrity of their customs bodies. For example, in Cameroon, a full 67% of respondents felt the sector was extremely corrupt. In Central and Eastern Europe, Bulgaria, Kosovo*, Moldova*, Romania*, Serbia*, and the Ukraine* specified their customs sector as the most corrupt, with other countries such as Lithuania and Macedonia also signalling grave concerns.

The public in Central and Eastern Europe is also worried about the integrity of the **medical sector**. While only respondents in Kosovo ranked their medical sector as the most corrupt, citizens from other countries in the region such as Bulgaria, Moldova, Poland, Serbia, and the Ukraine also gave this sector relatively poor marks. In addition, the public in a variety of countries, including Cameroon, India, Nicaragua, Pakistan, and Turkey expressed similar opinions.

No country signalled the education, utility, military, or registry and permit services as their most corrupt institution. Relative to medical services, the integrity of **education** systems seems somewhat better. The public in fewer countries signals this sector as a cause for concern. The public in Nicaragua and Turkey are notable examples, with citizens in these countries scoring the sector above four, on a scale from 1 of 5, 1 indications not at all and 5 extremely corrupt.

[3] Please note that Canada, Israel, Turkey and the USA are not included in the regional breakdown.

Utilities as well as registry and permit services achieve good results, in spite of the frequent contact with the public and cash transactions that would be expected from such parts of government. However, at the regional level, the public in Latin America appears to be more concerned about corruption in the **utilities sector**, with people from Ecuador, Nicaragua, and Paraguay indicating high levels of concern. Conversely, concerns about **registry and permit services** seem slightly more widespread, with more Asian and African countries, as well as some Latin American ones, such as Ecuador, Nicaragua, and Peru ranking the sector above four.

While the **military** was not ranked as the most corrupt institution in any country, the ratings of a cross-section of countries, notably in Africa and Latin America, indicate that the integrity of this body is not above reproach. The public in Bolivia, Cameroon, Ecuador, Ethiopia, Guatemala, Nigeria, Panama, Paraguay, Peru, Russia, Taiwan, and Togo indicated concerns about the public integrity of their armed forces.

While **NGOs** and **religious bodies** were perceived as the least corrupt institutions in aggregate terms, individual countries indicated signification levels of concern regarding each of them. The public in Turkey has questions about the integrity of NGOs in their country, and respondents in Japan, Greece and Israel report a significant level of concern regarding their local religious institutions.

Which spheres of life does corruption affect most?

The 2005 Global Corruption Barometer reemphasises one of the major findings of the 2004 Barometer, which is that corruption affects political life more than the business environment or respondents' personal and family life (see Table 10 Annex 1 for full results). Three quarters of all respondents stated that corruption affects political life to a moderate or large extent, compared with 70 per cent in 2004. However, the business sector was not so far behind, with 65 per cent saying that it was affected by corruption to a moderate or large extent. Although personal and family life was the sector thought to be least affected by corruption, a sizeable proportion of people (58% of respondents) stated that this sphere was affected by corruption to a moderate or large extent.

Political Life

Looking at the results in Table 3 below, there is no clear regional trend as to where political life is perceived to be a particular problem – rather it seems to be a global problem.

Of note is the poor performance of Canada, France, Italy, and Portugal among high income countries, where more than 55% of respondents believe that corruption affects political life to a large extent. This may in part be a reflection of recent corruption scandals in these countries.

Table 3: Where corruption affects political life to a large extent.

Where corruption affects political life to a large extent	More than 70%	Bosnia and Herzegovina, Bolivia, Greece, Israel, Peru, Philippines, Taiwan
	51% - 70%	Argentina, Bulgaria, Canada, Cameroon, Chile, Colombia, Croatia, Czech Republic, Dominican Republic, Ecuador, France, Ghana, Indonesia, India, Italy, South Korea, Lithuania, Macedonia, Mexico, Nigeria, Panama, Paraguay, Poland, Portugal, South Africa, Russia, Serbia, Thailand, Turkey
	31% - 50%	Costa Rica, Ethiopia, Georgia, Germany, Guatemala, Hong Kong, Ireland, Japan, Kosovo, Kenya, Moldova, Nicaragua, Pakistan, Romania, Senegal, Singapore, Togo, UK, Ukraine, Uruguay, USA
	11% - 30%	Austria, Cambodia, Denmark, Finland, Iceland, Luxembourg, Malaysia, Netherlands, Norway, Spain, Switzerland, Venezuela

Source: Transparency International Global Corruption Barometer 2005

The Business Environment

The business environment, while not thought to be as corrupt as political life at a global level, scores very poorly in many countries. This is particularly true in Africa, where at least 50% of respondents in Cameroon, Kenya and Togo believe that corruption affects the business environment to a large extent, and respondents in Ethiopia, Ghana, Kenya and Togo believed that corruption affects this sphere of life as much or more than either political life or their personal and family life. The public in several European and Asian countries also stressed the negative effects of corruption on the business environment. More than 50% of citizens from Bosnia and Herzegovina, Bulgaria, Croatia, Greece, Italy, Portugal, the Philippines, South Korea, and Taiwan felt that business had been adversely affected by corrupt practices. Conversely, fewer people in Latin America, with the exception of Peru, stated that corruption affected their business sectors.

Personal and Family Life

Respondents from most of the countries surveyed did not indicate that corruption affected their personal lives. Respondents from Nicaragua and Cambodia stated that corruption affected their family and personal lives as much, or more, than it did the other two sectors – perhaps indicating systemic corruption. Citizens from Bolivia, Bosnia and Herzegovina, Mexico, Panama, the Philippines, and Turkey also indicated that their personal lives were affected to a significant extent.

Table 4: The effect of corruption on personal life – by household income category

To what extent does corruption affect your personal life:	Low income	Middle income	High income
Not at all + small extent	54%	59%	62%
To a moderate + large extent	42%	38%	36%
Dk/Na	3%	3%	2%

Source: Transparency International Global Corruption Barometer 2005

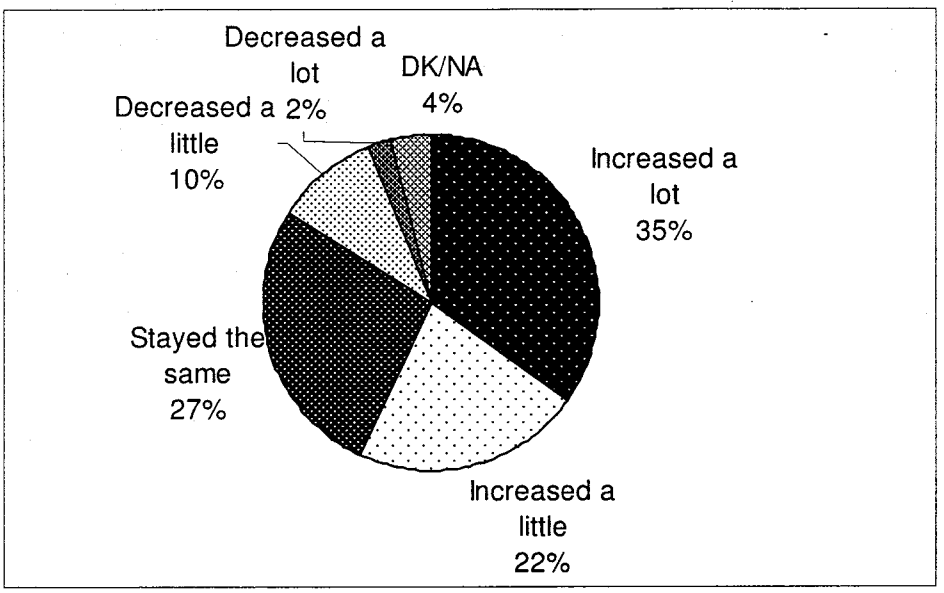
As perceptions of the effects of corruption differ across countries, so too do they differ across household income levels (Table 4). At the global level, there appears to be a link between income level and the extent to which respondents feel that

corruption affects their personal lives. Respondents with low incomes tend to have more negative views of the effect that corruption has on their personal lives compared to middle income and high income respondents. This is understandable, given that poorer families have fewer resources with which to buffer themselves from the effects of corruption.

How is corruption evolving over time?

When asked if corruption had gotten better or worse in their countries over the recent **past**, the public response was, on the whole, negative (Graph 2 and table 11 Annex 1 for full results). While in 6 countries (Colombia, Georgia, Hong Kong, Indonesia, Kenya and Singapore) there was a relative majority of positive views about the past, 57% of respondents thought that corruption had increased.

Graph 2: In the past three years, how has the level of corruption in this country changed?



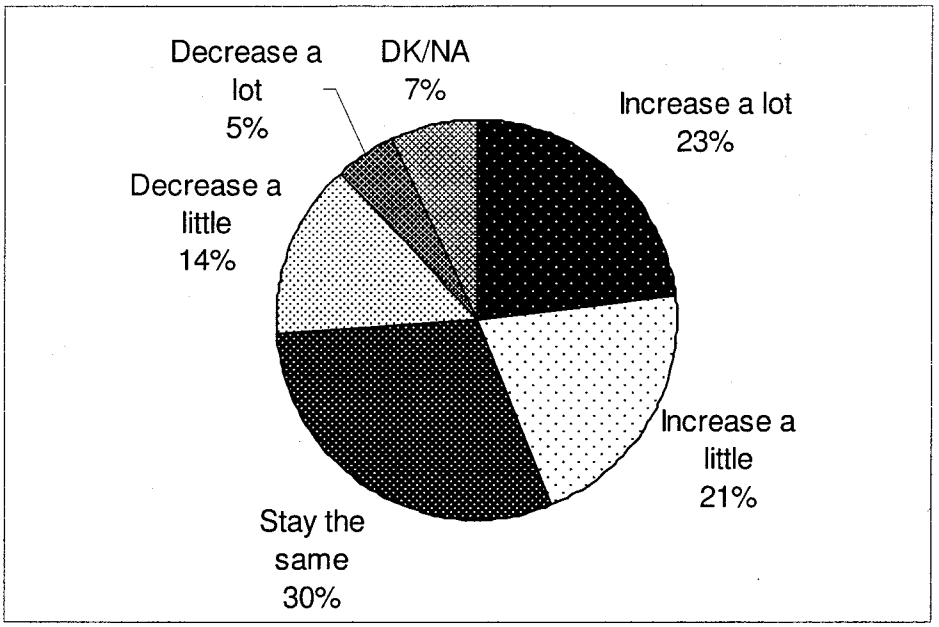
Looking at the results by region, it is clear that respondents in Latin American countries are the most negative. Respondents in 13 of the 15 countries think that corruption has gotten worse over the last three years. The public in Costa Rica, the Dominican Republic, Ecuador, and Nicaragua have a particularly negative opinion. Conversely, Argentina and Colombia stand out as exceptions, with most respondents stating that the level of corruption stayed the same in the former, and decreased in the latter.

The situation is similar in Africa, with citizens in six out of the eight countries stating that corruption has gotten worse. Senegal and Kenya stand out as positive exceptions, with the greater part of respondents stating that corruption has stayed the same or decreased. The picture in Asia, Western Europe, Central and Eastern Europe, and the Middle East is less uniformly negative. However, citizens in India, the Philippines, and Israel seem particularly discouraged about the recent prevalence of corruption. Interestingly, 65% and 58% of the public in the US and Canada respectively stated that corruption has increased. On the other hand, the public in Turkey and Indonesia

had a good impression of recent developments in corruption, with significant numbers stating that it had decreased slightly in the recent past.

Turning to perceptions of the **future**, the picture is less pessimistic (Graph 3 and table 12 Annex 1 for full results). Nevertheless, only 12 countries out of 69 were showing some relative optimism and 44% of respondents thought corruption would increase.

Graph 3: Do you expect the level of corruption in the next 3 years to change? Will it:



As with perceptions of the past, the responses to this question can be an important indicator of the success of anti-corruption measures - although these may be influenced by cultural factors. If the general public is optimistic, there still may be reasons to believe that real efforts are underway to curb corruption and promote transparency or that political change is bringing hope. If the public is pessimistic, it could be a reaction to a more adverse set of circumstances, such as lack of political will or lack of co-ordination or effectiveness of anti-corruption efforts. Pessimistic results may also reflect insufficient public knowledge about anti-corruption reforms. This is also important to know, as public awareness is important for maintaining support for governments and other stakeholders who are tackling bribery and corruption.

In particular, Africa stands out as a region of relative optimism. Of the eight countries covered by the Barometer, five had quite optimistic views about the future, especially in Nigeria and Ethiopia, where about half of the respondents felt that corruption would decrease in the next three years.

Respondents in Central and Eastern Europe were rather more cautious, although there are glimpses of optimism. Respondents in Kosovo, Ukraine and Romania were the most positive, with at least one third believing that the situation will get better. On the contrary, citizens in Poland, Lithuania, Bosnia and Herzegovina, and Russia, were the most pessimistic with nearly half of all respondents having negative views about the future. Respondents in Bosnia and Herzegovina, who were quite optimistic last year,

with 40% believing corruption would decrease a lot or a little, are now substantially more pessimistic, with 40% expecting corruption to increase. In Russia, where 38% felt in 2004 that corruption would increase a little or a lot in the next three years, respondents had a much more pessimistic perception this year, with fully half of them negative about the future.

While respondents in Latin America tend to be pessimistic, they are less negative when looking to the future than the past. The public in eight countries (Costa Rica, Ecuador, Mexico, Nicaragua, Panama, Paraguay, Peru, and Venezuela) indicate pessimistic views about the future, with half of respondents believing that corruption levels will increase. Nicaraguans are the most pessimistic in the region, with more than 6 out of 10 believing that the situation will get a lot worse. Otherwise, respondents from Chile, Colombia, and Uruguay showed positive assessments.

Most citizens in Western Europe stated that they expected levels of corruption to stay about the same. However, citizens in Germany, the Netherlands, and Norway were notably pessimistic. Looking at respondents from other high-income countries, respondents in the USA and Israel were also quite negative about future prospects.

Table 5: How will corruption change in the next three years?

The biggest pessimists: corruption will increase			
	2003	**2004**	**2005**
India	74%	80%	78%
Philippines	N/A*	70%	76%
Nicaragua	N/A*	N/A*	70%
Venezuela	N/A*	44%	62%
Sample average	**41%**	**45%**	**44%**

The biggest optimists: corruption will decrease			
	2003	**2004**	**2005**
Indonesia	55%	66%	81%
Uruguay	N/A*	28%	57%
Nigeria	39%	27%	51%
Kosovo	N/A*	52%	50%
Sample average	**19%**	**17%**	**19%**

Source: Transparency International Global Corruption Barometer 2005
**Country not included in Global Corruption Barometer 2003 / 2004.*

In Asia, people in the Philippines and India expressed strong concerns about future levels of corruption in their country, with approximately 60% of respondents assessing that the situation will get a lot worse. On the other hand, Indonesians were even more optimistic than last year.

There is a clear relationship between respondents' perceptions of a recent decrease in the prevalence of corruption and patterns in the future. Thus, countries such as Indonesia, Kenya, Colombia, and Turkey which are generally positive about the future have seen recent improvements as regards corruption. Conversely, citizens in India, the Philippines, Nicaragua, and Norway state that corruption has increased recently, and they expect things to continue worsening.

However, there are countries whose future prospects seem to differ from the recent past. The public in Ethiopia, Nigeria, Ghana, Kosovo, Macedonia, and Uruguay, for example, is markedly more optimistic than would be expected.

How frequently do people bribe?

As part of the Global Corruption Barometer, respondents were asked if they, or anyone in their household, had paid a bribe over the last twelve months. Countries were then placed into five groups, according to their response. The results provide valuable insight about how the frequency of bribery differs across countries, including those with similar income levels (Table 6 and table 13 Annex 1 for full country results). While data limitations restrict the number of countries about which observations can be made, the results yield interesting insights and show that corruption can take on a variety of forms in different contexts.

Table 6: Countries and the prevalence of bribery

Question - In the past 12 months, have you or anyone living in your household paid a bribe in any form? Answer - Yes	31% - 45%	Cameroon, Paraguay, Cambodia, Mexico
	11% - 30%	Ethiopia, Ghana, Guatemala, Lithuania, Moldova, Nigeria, Romania, Togo Bolivia, Czech Republic, Dominican Republic, Ecuador, Greece, Indonesia, India, Kenya, Pakistan, Peru, Russia, Senegal, Serbia, Ukraine
	5% - 10%	Argentina, Bulgaria, Bosnia and Herzegovina, Colombia, Croatia, Kosovo, Luxembourg, Macedonia, Malaysia, Nicaragua, Panama, Philippines, Poland, South Africa, Thailand, Turkey, Venezuela
	Less than 5%	Austria, Canada, Costa Rica, Denmark, Spain, Finland, France, Germany, Hong Kong, Iceland, Ireland, Israel, Japan, South Korea, Netherlands, Norway, Portugal, Singapore, Switzerland, Taiwan, UK, Uruguay, USA

Source: Transparency International Global Corruption Barometer 2005

As can be seen, the prevalence of bribery varies considerably. At one end, a very low percentage of families in mostly high-income countries admitted bribing over the course of the past year. At the other, a relatively high proportion of families in a group of Eastern European, African, and Latin American countries admitted paying a bribe in the previous twelve months. Before conducting any comparison, it is important to underline that some differences in terms of experience of bribery may relate to differences in real level of petty corruption as well as in the definition of a bribe.

It is interesting to note the differences within regions. On one hand, very few families in Costa Rica and Uruguay paid bribes, yet more than one-fifth of families in Guatemala and more than two-fifths of families in Paraguay had done so. Similarly, less than 10% of households in South Africa and more than 40% of those in Cameroon had done so. Thailand and Cambodia display a similar difference.

While the countries with the lowest levels of bribery are high or upper middle income, there is also considerable variance across income groups. While Cambodia, Cameroon, and Ethiopia are low-income countries and have a high prevalence of bribery, Mexico and Lithuania are upper middle-income countries and have similarly high levels of bribery. Greece and Luxembourg also have comparatively high levels of bribery given their income level.

How much does it cost?

The following section of the report includes an attempt to assess the cost of bribery in a limited range of countries[4]. Just as the frequency of bribery varies across countries, so too do the amounts asked for. In some countries, bribes may be paid more frequently, but be of lower amounts. Conversely, in other contexts, they may be asked for less frequently, but be larger. Thus, respondents were asked how much their families had paid in bribes over the course of the previous year (Table 7).

As can be seen, the average amount of bribes paid varies widely across countries, from a low of US$ 36 in Paraguay to US$ 205 in Cameroon. These differences can be witnessed even in countries from similar regions. For example, while respondents from Pakistan claimed to have paid US$ 45 in bribes over the course of the previous year, those in India had paid more than twice that amount. Similarly, while citizens from Kenya and Togo had paid approximately US$ 50 in the past year before, this quantity was substantially lower than what citizens in Nigeria (US$ 114) had paid.

Table 7: How much is spent in bribes

Bribes paid by household members over the previous 12 months	Nominal amount in Current USD	Amount in purchasing power parity USD
Bolivia	66	190
Cameroon	205	560
Dominican Republic	76	274
Ghana	181	1095
Guatemala	147	303
India	102	523
Kenya	50	114
Lithuania	195	432
Mexico	111	166
Moldova	86	280
Nigeria	114	280
Pakistan	45	169
Paraguay	36	158
Peru	69	164
Romania	56	154
Russia	129	393
Serbia	171	No data
Togo	46	216
Ukraine	160	860

Source: Transparency International Global Corruption Barometer 2005, and World Bank Development Indicators Online, http://publications.worldbank.org/WDI/.

That said, it must be remembered that per capita income and purchasing power varies significantly across countries, meaning that the economic significance of bribes differs from one context to another. Table 9 relates the total amount of bribes paid to Gross Domestic Product (GDP) per capita, to give an idea of what this amount implies for families in each country.

[4] Only 19 countries only have been covered under this section. The data are derived from the sub-sample of respondents who stated that they had paid a bribe in the past year. In some countries, the sub-sample size is too small to enable categorical statements to be made. Thus, the information discussed here comes from countries where more than 10% of the population has stated they have paid bribes and the sub-sample is at least 100 people. Ethiopia has not been included due to problems with the data.

Citizens in Africa seem to pay large amount of their income in bribes. Given these countries' low overall income and high rates of poverty, it is clear that bribery is a particularly heavy burden on these citizens. Along the same line, citizens from India, Kenya, Togo, Moldova and the Ukraine must pay between a tenth and a fifth of income per capita. Citizens from the rest of the countries have to pay less than 10% of GDP per capita. In these countries, the price of bribery is the dramatic increase in inequality, given the added weight of these expenses for the poor.

Table 8: The size of bribes compared with GDP / capita

Average amount paid in bribes per household per year, as a percentage of GDP per capita[5]	+ 20%	Cameroon, Ghana, Nigeria
	10-20%	India, Kenya, Moldova, Togo, Ukraine
	<10%	Bolivia, Dominican Republic, Guatemala, Lithuania, Mexico, Pakistan, Paraguay, Peru, Romania, Russia, Serbia

Source: Transparency International Global Corruption Barometer 2005

What form does bribery take?

As the frequency of bribery differs, so too do its manifestations. Thus, the Barometer explores this by asking those respondents who bribed the following questions: were bribes directly asked for; were they offered by the respondents themselves, and if so, were they offered to avoid problems with authorities or to obtain access to a service they were entitled to?

Graph 4 shows the frequency with which a bribe was directly asked for. Again, the following analysis only refers to a limited number of countries, due to data limitations[6].

A majority of citizens in Bolivia, the Dominican Republic, India, Mexico, Nigeria, Peru and Paraguay stated that a bribe had been directly asked of them. Approximately half of respondents from Moldova, Pakistan, Cameroon, Kenya, Ghana and Ethiopia said the same.

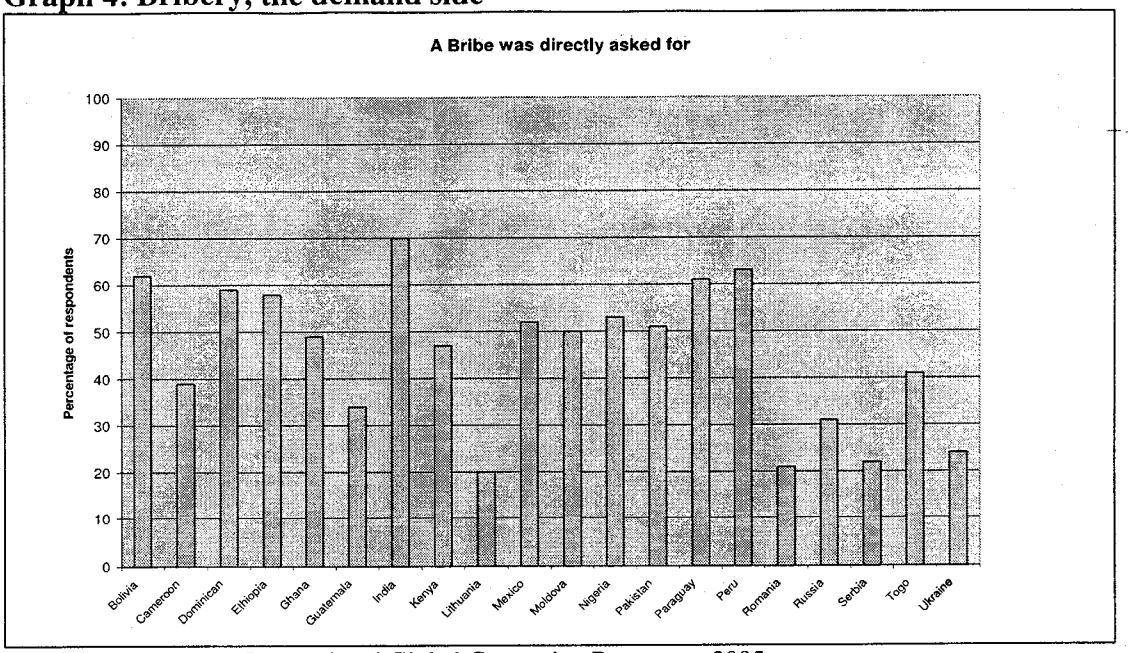
However, the majority of respondents surveyed from Central and Eastern European countries such as Lithuania, Romania, Russia, Serbia and Ukraine reported that the bribes they had paid had not been directly solicited. This was echoed by respondents from Guatemala. The results from these countries indicate that, in many contexts, bribery is an implicit requirement, and that it is often a 'supply-side' – and not just a 'demand-side' – phenomenon.

---

[5] United Nations Development Programme (UNDP), Human Development Report 2005: http://hdr.undp.org/

[6] 20 countries only have been covered under this section. Indeed, the data are derived from the sub-sample of respondents who stated that they had paid a bribe in the past year. In some countries, the sub-sample size is too small to enable categorical statements to be made. Thus, the information discussed here comes from countries where more than 10% of the population has stated they have paid bribes and the sub-sample is at least 100 people.

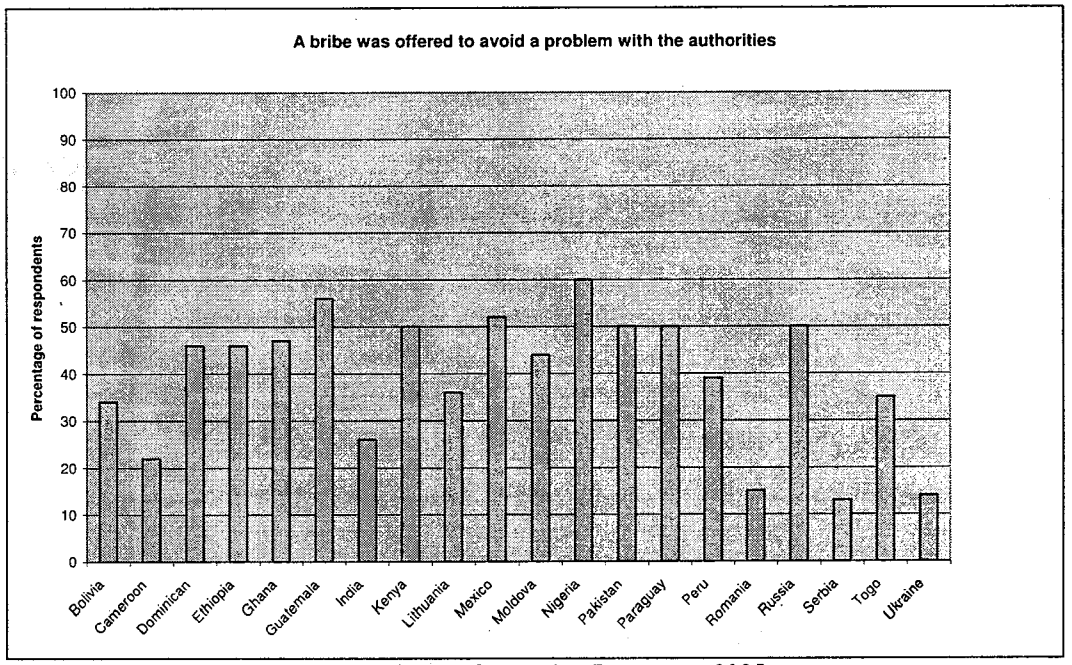
Graph 4: Bribery, the demand side



Source: Transparency International Global Corruption Barometer 2005

As can be seen from Graph 5 below, offering a bribe to avoid problems with the authorities is a relatively frequent occurrence. This was the case for at least half of respondents from Russia, and from Latin American countries such as Guatemala, Mexico, the Dominican Republic and Paraguay. Citizens from Pakistan, Kenya and Nigeria said that they had done the same. While offering to pay bribes can be seen as the 'supply side' of corruption, it is also possible that these bribes were tacitly requested or bureaucratic processes deliberately slowed to solicit 'grease' money.

Graph 5: Bribery, the Supply Side



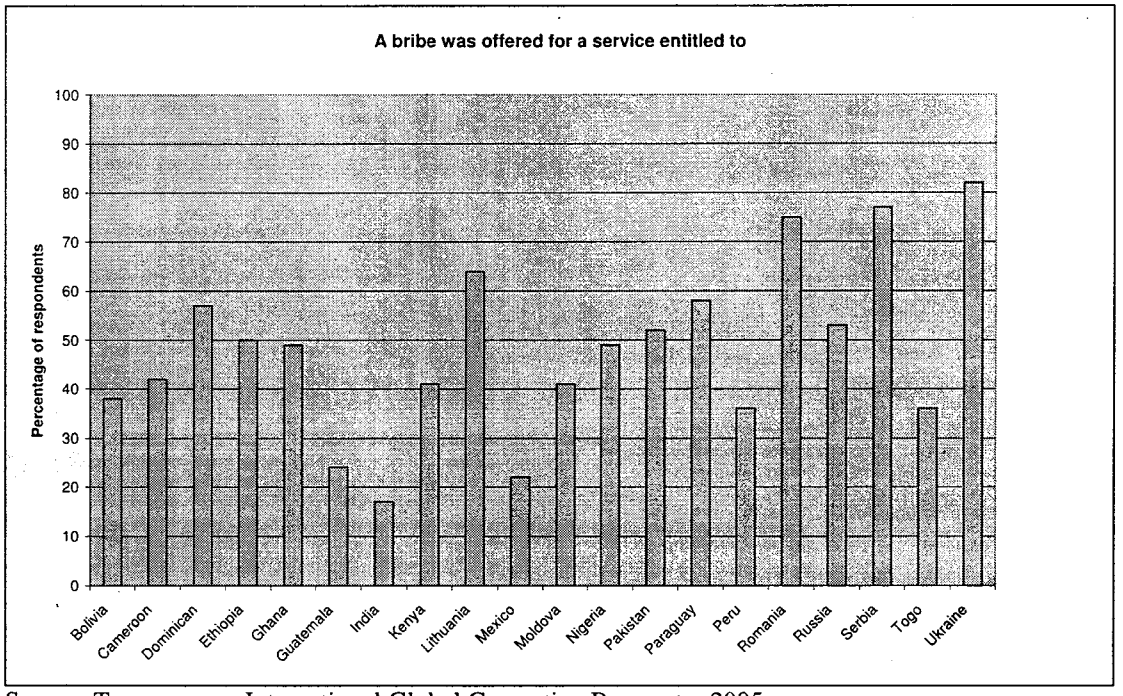
Source: Transparency International Global Corruption Barometer 2005

'Facilitating' bribes to avoid problems with the authorities were not prevalent in all countries, as a majority of respondents from former socialist countries such as Lithuania, Romania, Serbia, and Ukraine indicated that they had not paid bribes for this purpose. Similarly, the bulk of respondents from Bolivia, Peru, India, Cameroon and Senegal reported that this had not been the case for them. However, as people are often reluctant to discuss the issue of corruption (and admit their role in the transaction), it is possible that the frequency of bribes is under-estimated.

Regarding paying bribes offered for access to public services, a significant majority of respondents from former socialist countries such as Lithuania, Romania, Russia, and Serbia confirmed that this had been their experience (Graph 6). In Ukraine, this was stated by more than 80% of citizens. More than half of those surveyed in the Dominican Republic, Paraguay and Pakistan indicated similar experiences.

Conversely, approximately four-fifths of those surveyed in India and Senegal stated that they had not paid bribes to access services they were entitled to. More than 50% of respondents in Bolivia, Ecuador, Guatemala, Mexico, and Peru reported similarly. While this finding could mean that access to services in these countries is easier and transparent, it could also imply that service networks in these countries are less extensive.

Graph 6: Bribes for public services



Source: Transparency International Global Corruption Barometer 2005

Conclusion

The TI Global Corruption Barometer provides a snapshot of the perceptions and experiences of citizens from around the world with regard to corruption in their countries. This year's findings again reflect the general public's mistrust in their national political and justice systems, with political parties, parliaments, the police and the judiciary perceived to be the sectors most affected by corruption.

Political parties were given the worst overall score, and were seen as the most corrupt sector in 45 out of 69 countries. This result reflects a worsening of the global opinion of political parties, as last year 36 out of a total 62 countries rated their parties as the most corrupt institution. Parliaments received a similarly negative score, indicating widespread concern about the effects of corruption on political systems.

The results at the regional level are slightly different. While citizens in Asia, Western Europe, and Latin America pinpoint their political parties and parliaments as the most corrupt, the public in Africa is most concerned about the integrity of their police forces, and citizens in Central and Eastern Europe regard the police and their party system as equally corrupt.

In terms of the judiciary, the most critical views were captured in Central and Eastern Europe and Latin America, where this sector was ranked one of the three most corrupt. Customs were particularly badly perceived in Africa, Latin America and most of Central and Eastern Europe. Regarding the business sector and the media, the most critical views were expressed in Western Europe, especially in Scandinavian countries. While the health and education sectors were not scored particularly harshly, there were significant levels of concern in a large number of countries, indicating that unofficial 'user charges' may be hindering the access of many people to basic social services.

In terms of the impact of corruption on different spheres of life, respondents clearly stated that the political spheres in their countries are affected by corruption. However, a high percentage of people also thought that the business sector was similarly affected. This was particularly the case for citizens in Africa and Western Europe. Conversely, fewer people in Latin America had this opinion. While a smaller number thought their personal lives were directly affected by corruption, citizens from a few countries indicated very strongly that their lives were negatively influenced. In addition, respondents with low incomes tend to have more negative views of the effect that corruption has on their personal lives compared to middle income and high income respondents.

Regarding perceptions of the prevalence of corruption over the last three years, the response was, on the whole, negative. A full 57% of those surveyed thought that corruption had increased – either a little or a lot. Respondents in Latin America and Africa were the most negative. Responses from the other regions were more mixed.

Looking to the future, respondents were less pessimistic – the average person thought that corruption would stay the same rather than worsen. Despite stating that corruption had increased in the recent past, respondents from Latin America and, in particular,

Africa tended to have a more positive outlook for the future. Respondents in a small number of countries like Uruguay, Colombia, Nigeria, and Ethiopia are more optimistic about the future than they were about the past.

Regarding the prevalence of bribery, while citizens from predominantly rich countries report low levels of bribery and those from poorer nations report comparatively higher levels, there are still significant differences across regions and income groups. Neighbouring countries can admit very different levels of bribery, as in the cases of Cambodia and Thailand, or Guatemala and Nicaragua. Countries with similar income levels can also have varying levels of bribery: the Philippines and Paraguay are both lower middle-income countries, yet only 9% of Filipinos surveyed stated they had paid bribes the year before, compared to 43% of Paraguayans.

The cost of bribery can be significant for households. When compared to GDP per capita, it is clear that families in some countries must spend an inordinate amount of their incomes on bribes. In 11 out of the 19 countries for which data is available, families spend less than the equivalent of 10% of GDP per capita. However, in the rest, households must spend more than this. In countries like Cameroon, Nigeria, and Ghana families must spend the equivalent of at least a fifth of GDP per capita paying a 'bribery tax'.

Regarding forms of bribery, some regional patterns can be discerned. It is more common in Latin America and South Asia for bribes to be asked for directly. However, it is more common in Eastern Europe for bribes to be paid to access public services, and less likely in other parts of the world.

Overall, corruption remains a big concern for citizens around the world, who pinpoint their political and judicial systems first and foremost. However, while political corruption is cited as a major problem in many countries, it is also clear that bribery and petty corruption weigh heavily on the public in many poor nations.

Annexes

Annex I

Global Corruption Barometer 2005
Full country tables

Table 9: National institutions and sectors, corrupt or clean?

To what extent do you perceive the following sectors in this country/territory to be affected by corruption? (1: not at all corrupt, ... 5: extremely corrupt)	Political parties	Parliament / Legislature	Police	Legal system / Judiciary	Tax revenue	Business / private sector	Customs	Medical services	Media	Education system	Utilities	Registry and permit services	The military	NGOs	Religious bodies
Cambodia	2.9	2.4	3.2	3.9	3.1	2.6	3.8	2.8	2.2	2.2	2.1	2.3	2.5	1.5	1.8
Hong Kong	3.1	2.5	2.9	2.4	2.1	3.2	2.6	2.2	3.0	2.3	2.1	1.9	2.3	2.4	2.0
India	4.7	4.4	4.7	4.3	3.8	3.4	4.1	3.8	2.7	3.8	3.7	4.0	2.1	3.0	2.9
Indonesia	4.2	4.0	4.0	3.8	3.8	3.5	4.0	2.7	2.4	3.0	3.0	3.5	2.9	2.4	2.1
Japan	4.2	3.7	3.8	3.0	3.5	3.3	2.9	3.6	3.4	3.1	3.2	2.7	3.0	3.0	3.8
Malaysia	3.7	3.1	4.0	2.9	2.8	3.1	3.4	2.3	2.4	2.3	2.4	3.2	2.4	2.5	1.9
Pakistan	3.9	3.7	4.3	4.0	3.9	3.4	4.0	3.7	3.3	3.4	3.8	3.7	3.1	3.1	2.5
Philippines	4.2	4.2	4.0	3.4	3.7	3.2	3.7	2.9	2.5	3.0	3.1	3.3	2.7	2.5	2.0
Singapore	2.2	1.8	2.0	2.1	1.8	2.7	2.0	1.7	2.2	1.8	1.7	1.8	1.9	2.6	2.2
South Korea	4.4	4.4	3.7	3.7	3.5	3.5	3.6	3.3	3.5	3.6	2.4	2.4	3.4	2.9	3.0
Taiwan	4.1	4.3	3.4	3.4	3.1	3.2	3.6	3.1	2.7	2.8	3.2	1.8	3.5	2.0	2.2
Thailand	3.9	2.8	3.8	2.8	2.8	2.9	3.2	2.4	2.5	2.8	2.6	2.2	2.6	2.6	2.2
ASIA - average	4.2	3.9	3.9	3.4	3.5	3.3	3.4	3.3	3.0	3.1	3.1	2.9	2.9	2.8	2.9
Cameroon	3.9	3.3	4.7	4.3	4.0	3.7	4.4	3.7	2.9	3.6	2.7	3.6	3.6	2.5	2.0
Ethiopia	3.6	3.2	3.7	3.7	3.8	3.8	3.6	3.4	3.5	3.4	3.2	2.7	3.6	2.5	2.4
Ghana	4.1	3.1	4.7	3.8	3.7	3.2	4.2	2.9	3.1	3.5	3.7	3.1	2.3	2.5	2.2
Kenya	3.7	3.8	4.1	3.6	3.4	2.9	3.7	3.2	2.3	2.5	3.2	3.7	2.5	2.3	2.0
Nigeria	4.5	4.1	4.7	3.8	3.6	3.2	4.2	3.0	2.8	3.8	3.6	3.1	3.8	2.5	2.3
Senegal	3.6	3.1	3.7	3.2	2.8	2.8	3.6	2.7	2.4	2.5	2.0	3.1	1.9	2.1	1.8
South Africa	4.0	3.7	4.0	3.3	2.7	3.0	2.9	3.0	2.6	2.8	2.9	3.8	2.7	2.7	2.3
Togo	3.6	3.5	3.9	3.9	3.4	3.3	4.2	3.0	3.0	2.9	3.1	3.6	3.5	2.2	2.1
AFRICA - average	4.2	3.8	4.4	3.7	3.5	3.1	4.0	3.0	2.7	3.4	3.4	3.3	3.2	2.5	2.2
Austria	3.6	3.1	2.8	2.8	2.8	3.0	2.7	2.5	3.0	2.4	2.3	2.8	2.7	2.3	2.5
Denmark	2.7	2.5	2.0	2.0	1.8	2.8	1.8	2.1	2.8	1.9	1.9	1.6	2.0	2.2	1.8
Finland	3.1	2.7	1.7	2.0	1.9	2.8	1.8	2.0	2.9	1.8	2.0	1.7	1.7	2.2	2.4
France	4.1	3.4	3.1	3.1	2.5	3.5	2.7	2.3	3.4	2.0	2.3	2.2	2.4	2.5	2.4
Germany	3.7	3.2	2.4	2.7	2.9	3.2	2.6	2.8	3.3	2.3	2.7	2.1	2.5	2.6	2.4
Greece	4.1	3.5	3.3	3.7	3.8	3.4	3.5	3.6	3.7	2.7	3.3	2.5	2.5	2.6	3.7
Iceland	3.3	2.6	2.0	2.3	1.8	3.1	2.0	1.9	3.1	1.5	2.8	1.7	.	2.0	1.7
Ireland	3.7	3.1	2.7	3.2	2.8	3.1	2.2	2.4	2.8	2.0	2.2	1.8	2.0	2.2	2.7
Italy	4.2	3.6	2.5	3.2	3.5	3.5	2.9	3.5	3.3	2.6	2.6	3.5	2.4	2.4	2.2
Luxembourg	3.4	2.8	2.7	2.6	2.4	3.3	2.3	2.1	3.0	2.2	2.1	2.4	2.1	2.3	2.7
Netherlands	3.0	2.8	2.9	2.7	2.4	3.1	2.7	2.3	3.1	2.2	2.9	2.4	2.5	2.6	2.4
Norway	3.2	2.7	2.4	2.2	2.0	3.5	2.2	2.6	3.2	2.0	2.5	1.9	2.7	2.8	3.2
Portugal	3.9	3.3	3.0	3.3	3.7	3.4	3.3	2.9	2.9	2.7	2.6	2.6	2.4	2.6	2.6
Spain	3.4	3.2	3.1	3.2	3.3	3.3	2.8	2.9	3.1	2.7	2.9	2.8	2.9	2.7	3.0
Switzerland	3.2	2.7	2.2	2.3	2.5	2.9	2.1	2.3	2.9	1.9	2.3	2.0	2.3	2.3	2.3
United Kingdom	3.5	3.2	2.8	2.9	2.5	3.0	2.4	2.2	3.2	2.1	2.3	2.0	2.5	2.5	2.4
W.EUROPE - average	3.7	3.3	2.7	2.9	2.9	3.3	2.7	2.7	3.3	2.3	2.6	2.5	2.5	2.5	2.5
Bosnia and Herzegovina	4.5	4.2	4.0	4.1	3.5	3.8	3.9	3.9	3.1	3.6	2.5	2.9	2.4	2.3	2.6
Bulgaria	4.3	4.2	3.8	4.3	3.4	3.8	4.5	4.1	3.2	3.4	2.8	3.6	2.7	3.1	2.7

To what extent do you perceive the following sectors in this country/territory to be affected by corruption? (1: not at all corrupt, ... 5: extremely corrupt)	Political parties	Parliament / Legislature	Police	Legal system / Judiciary	Tax revenue	Business / private sector	Customs	Medical services	Media	Education system	Utilities	Registry and permit services	The military	NGOs	Religious bodies
Croatia	4.0	3.8	3.3	3.9	3.3	3.6	3.3	3.5	3.0	2.9	3.0	3.3	2.6	2.5	2.6
Czech Republic	3.7	3.3	3.7	3.4	2.7	3.1	3.4	2.9	2.7	2.5	2.2	2.4	2.6	2.3	2.2
Georgia	3.6	3.6	2.9	3.9	3.5	3.4	3.6	3.1	2.9	2.9	2.6	3.1	2.5	2.8	2.0
Kosovo	3.1	2.5	1.9	3.0	2.7	3.0	3.4	3.4	2.2	2.4	3.0	2.6	1.2	2.2	1.6
Lithuania	4.3	4.1	4.1	4.2	3.3	3.6	4.2	3.9	2.9	3.1	2.5	2.9	2.4	2.7	2.1
Macedonia	4.1	4.0	3.5	4.3	3.4	3.5	4.2	3.9	3.0	3.7	2.8	2.8	2.4	2.6	2.2
Moldova	3.8	3.6	4.2	3.8	2.9	3.5	4.2	4.0	3.0	3.9	2.7	3.3	2.8	2.7	2.1
Poland	4.2	4.1	3.9	4.0	3.1	3.8	2.7	4.1	2.8	2.9	2.6	3.5	2.6	2.8	2.5
Romania	3.8	3.6	3.6	3.7	2.4	3.4	3.8	3.6	2.7	2.9	2.5	2.9	2.4	2.5	2.1
Russia	4.0	3.9	4.2	3.9	3.8	3.8	3.7	3.5	3.4	3.7	3.1	3.5	3.5	2.7	2.2
Serbia	4.2	3.8	4.0	4.1	3.2	3.8	4.2	4.0	3.7	3.7	2.9	2.9	2.9	3.4	2.3
Ukraine	3.9	3.8	4.1	4.1	3.6	3.8	4.1	4.0	3.1	3.8	2.5	3.3	3.0	3.0	2.3
CE EUROPE-average	4.0	3.9	4.0	3.9	3.5	3.7	3.7	3.7	3.2	3.5	2.9	3.4	3.1	2.7	2.3
Argentina	4.6	4.5	4.3	4.3	3.4	3.6	4.2	3.0	3.4	3.0	3.3	3.6	3.2	2.8	3.0
Bolivia	4.8	4.6	4.7	4.3	3.5	3.4	4.4	3.2	3.0	3.3	3.2	3.1	3.8	3.2	2.3
Chile	4.2	3.8	3.5	4.1	3.2	3.5	3.3	2.6	3.0	2.4	3.0	2.8	3.0	2.6	2.2
Colombia	4.4	4.2	3.8	3.8	3.6	3.1	3.6	3.2	3.0	3.0	3.5	3.1	3.2	3.0	2.7
Costa Rica	4.6	4.2	3.8	3.6	4.1	3.5	4.0	3.5	3.1	3.1	3.6	3.2	.	3.0	3.2
Dominican Republic	4.3	3.7	4.3	3.8	3.8	3.3	3.7	3.4	3.2	3.1	3.5	3.4	3.4	3.0	3.0
Ecuador	4.9	4.9	4.3	4.6	3.7	3.4	4.5	3.5	3.3	3.6	4.1	4.4	3.6	2.9	2.8
Guatemala	4.2	4.0	4.2	3.9	4.0	3.7	3.8	3.6	3.5	3.4	3.7	3.6	3.9	3.4	3.2
Mexico	4.7	4.4	4.7	4.5	3.9	3.5	4.2	3.2	3.3	3.1	3.6	4.0	3.1	3.3	2.9
Nicaragua	4.6	4.4	4.3	4.4	4.4	3.9	4.1	4.0	3.7	4.1	4.2	4.1	3.4	3.3	3.0
Panama	4.7	4.7	4.4	4.5	3.9	3.5	4.0	3.2	3.2	3.3	3.5	3.4	3.9	3.0	2.4
Paraguay	4.8	4.7	4.7	4.6	4.1	3.5	4.6	3.9	3.1	3.6	4.0	3.8	4.2	3.0	2.8
Peru	4.5	4.5	4.4	4.5	3.9	3.4	3.4	3.6	3.7	3.8	3.6	4.1	4.1	3.3	2.6
Uruguay	4.0	3.4	3.9	3.5	3.0	3.2	4.0	3.2	2.8	2.6	2.9	2.3	2.9	2.2	2.9
Venezuela	3.7	3.7	3.7	3.4	3.2	3.3	3.4	3.3	3.2	3.1	3.2	3.4	3.2	3.2	3.2
LAC - average	4.5	4.4	4.3	4.3	3.7	3.5	4	3.2	3.3	3.2	3.5	3.7	3.3	3.1	2.8
Israel	4.5	4.2	3.3	2.9	3.2	3.2	3.0	3.0	3.3	3.0	3.2	3.1	2.5	3.1	3.8
Turkey	4.1	3.9	4.0	4.0	4.2	4.0	4.1	4.1	3.8	4.0	4.0	3.7	3.3	3.6	3.4
Canada	3.9	3.6	2.7	3.2	2.9	3.0	2.5	2.5	3.1	2.3	2.7	2.2	2.5	2.4	2.6
USA	3.9	3.5	3.1	3.5	3.4	3.2	3.0	3.1	3.5	3.0	3.0	2.5	2.9	3.0	2.8
Total	**4.0**	**3.7**	**3.6**	**3.5**	**3.4**	**3.4**	**3.3**	**3.2**	**3.2**	**3.0**	**3.0**	**2.9**	**2.9**	**2.8**	**2.6**

Note: Sectors in the table above are listed from left to right according to their global score. The shaded boxes indicate the highest (or joint highest) rated institution/sector for each country/territory.

Table 10: Corruption's impact on political life, the business environment, and personal and family life

Some people believe that corruption affects different spheres of life in this country. In your view does corruption affect: (1: Not at all ... 4: To a large extent)	Political life	The business environment	Your personal and family life
Argentina	3.3	3.0	2.4
Austria	2.5	1.7	1.4
Bolivia	3.9	3.0	3.2
Bosnia and Herzegovina	3.6	3.5	3.3
Bulgaria	3.6	3.4	2.0
Cambodia	2.3	2.4	2.4
Cameroon	3.5	3.4	2.2
Canada	3.3	3.1	2.1
Chile	3.3	3.1	2.0
Colombia	3.2	3.0	2.6
Costa Rica	3.0	2.8	2.7
Croatia	3.5	3.6	2.3
Czech Republic	3.4	3.1	1.8
Denmark	2.4	2.6	1.6
Dominican Republic	3.1	3.0	2.8
Ecuador	3.0	3.0	2.7
Ethiopia	3.2	3.3	2.8
Finland	2.6	2.4	1.3
France	3.4	2.4	1.4
Georgia	3.5	3.5	2.8
Germany	3.2	2.1	1.7
Ghana	3.1	3.1	2.7
Greece	3.7	3.6	2.5
Guatemala	3.2	2.9	2.5
Hong Kong	3.1	2.9	2.5
Iceland	3.1	3.0	1.9
India	3.2	2.9	2.6
Indonesia	3.3	3.2	2.5
Ireland	3.3	3.0	1.7
Israel	3.7	3.5	2.7
Italy	3.4	3.5	1.5
Japan	2.4	2.2	1.7
Kenya	3.2	3.3	3.2
Kosovo	2.9	2.7	2.2
Lithuania	3.6	3.4	2.2
Luxembourg	2.8	2.8	1.8
Macedonia	3.4	3.2	2.6
Malaysia	3.1	2.9	2.1
Mexico	3.4	3.0	3.0
Moldova	3.1	3.0	2.5
Netherlands	2.5	2.8	1.5
Nicaragua	3.0	3.0	3.0
Nigeria	3.2	3.0	2.6
Norway	2.8	2.9	1.3
Pakistan	3.2	3.1	2.8
Panama	3.5	3.2	3.0
Paraguay	3.4	3.1	2.6
Peru	3.7	3.3	2.9
Philippines	3.6	3.6	3.5
Poland	3.6	3.4	2.1
Portugal	3.6	3.5	2.0
Romania	3.2	3.2	2.5
Russia	3.4	3.1	2.0
Senegal	3.3	2.9	1.5
Serbia	3.2	2.9	2.3
Singapore	2.7	2.7	2.0
South Africa	3.2	2.8	2.2
South Korea	3.6	3.5	2.9
Spain	2.6	2.2	1.7
Switzerland	2.7	2.9	1.5
Taiwan	3.8	3.7	2.9
Thailand	3.2	3.3	2.8
Togo	3.1	3.1	2.1
Turkey	3.3	3.3	3.1
Ukraine	3.3	3.1	1.9
United Kingdom	3.0	2.8	1.6
Uruguay	3.3	2.9	2.3
USA	3.2	3.0	2.2
Venezuela	2.8	2.7	2.4
Total	**3.2**	**3.0**	**2.2**

Table 11: How have corruption levels increased or decreased over the past three years?

In the past 3 years, how has the level of corruption in this country changed?	% Increase a lot	% Increase a little	% Stay the same	% Decrease a little	% Decrease a lot	% Don't know / no answer
Argentina	17	23	39	17	1	3
Austria	11	18	31	4	4	30
Bolivia	53	17	21	7	2	1
Bosnia and Herzegovina	34	31	24	7	1	4
Bulgaria	21	16	30	9	1	23
Cambodia	28	24	26	11	2	9
Cameroon	45	26	15	11	0	3
Canada	32	26	33	3	1	5
Chile	35	19	31	12	0	3
Colombia	23	13	27	31	7	0
Costa Rica	72	7	18	2	1	1
Croatia	30	17	36	11	2	4
Czech Republic	19	29	37	8	1	6
Denmark	5	35	50	6	0	4
Dominican Republic	72	8	11	8	1	0
Ecuador	69	13	15	1	1	1
Ethiopia	42	19	16	17	3	2
Finland	7	26	34	9	1	24
France	19	29	35	6	1	9
Georgia	11	9	27	33	13	8
Germany	34	32	25	5	2	3
Ghana	35	16	16	21	4	7
Greece	45	20	24	9	2	0
Guatemala	38	23	26	9	2	2
Hong Kong	7	20	35	24	8	6
Iceland	16	33	34	6	1	10
India	62	22	9	7	0	0
Indonesia	15	13	27	35	5	4
Ireland	30	19	26	18	5	2
Israel	65	14	17	1	1	2
Italy	28	22	38	9	1	2
Japan	26	22	44	7	1	1
Kenya	16	14	17	42	6	6
Kosovo	29	19	24	12	2	14
Lithuania	30	30	22	5	1	12
Luxembourg	8	28	44	5	1	14
Macedonia	39	18	27	10	1	4
Malaysia	18	21	25	21	1	13
Mexico	40	19	29	9	2	1
Moldova	23	27	28	15	1	6
Netherlands	21	40	18	4	1	17
Nicaragua	74	7	14	5	1	
Nigeria	59	14	10	13	4	0
Norway	7	50	27	5	1	11
Pakistan	39	28	16	7	1	10
Panama	55	8	28	7	1	1
Paraguay	52	12	22	11	2	1
Peru	59	14	19	8	0	1
Philippines	70	14	9	6	1	0
Poland	44	18	29	3	0	5
Portugal	42	26	21	4	1	6
Romania	23	14	34	17	2	10
Russia	39	23	26	6	1	5
Senegal	19	20	23	17	3	18
Serbia	31	17	33	12	1	7
Singapore	5	11	40	15	10	18
South Africa	48	19	16	11	3	3
South Korea	16	29	34	16	1	4
Spain	29	19	35	7	2	8
Switzerland	21	29	36	8	0	7
Taiwan	22	9	41	18	5	6
Thailand	39	12	22	19	5	4
Togo	44	16	17	13	4	6
Turkey	18	21	15	28	7	10
Ukraine	19	22	31	12	1	15
United Kingdom	24	29	33	4	2	8
Uruguay	37	20	33	7	1	4
USA	43	22	23	7	4	2
Venezuela	59	12	15	11	1	2
Total	**35**	**22**	**27**	**9**	**2**	**5**

Table 12: Expectations: will corruption levels increase or decrease over the next three years?

Do you expect the level of corruption in the next 3 years to change?	% Increase a lot	% Increase a little	% Stay the same	% Decrease a little	% Decrease a lot	% Don't know / no answer
Argentina	9	12	43	25	2	10
Austria	10	24	36	4	2	25
Bolivia	16	15	34	15	8	13
Bosnia and Herzegovina	15	25	31	19	3	7
Bulgaria	7	8	31	17	3	34
Cambodia	19	20	15	16	5	25
Cameroon	26	13	22	22	13	4
Canada	16	22	40	14	3	5
Chile	8	12	37	26	3	13
Colombia	17	13	28	30	8	5
Costa Rica	46	9	24	13	2	6
Croatia	13	12	38	26	6	5
Czech Republic	10	22	44	14	3	7
Denmark	4	29	57	6	2	2
Dominican Republic	34	9	16	25	9	7
Ecuador	47	14	22	3	4	11
Ethiopia	17	10	16	35	13	9
Finland	8	32	34	8	1	17
France	12	23	40	10	1	14
Georgia	5	3	29	24	14	25
Germany	26	31	30	9	1	4
Ghana	22	10	14	19	23	11
Greece	25	16	26	21	9	3
Guatemala	36	21	28	9	3	3
Hong Kong	4	18	42	23	7	6
Iceland	8	29	42	11	1	9
India	57	21	9	8	1	4
Indonesia	8	2	7	18	63	2
Ireland	13	19	37	22	6	3
Israel	22	39	26	8	1	4
Italy	18	23	38	13	1	8
Japan	19	23	47	8	1	1
Kenya	13	12	20	31	12	12
Kosovo	10	6	16	31	19	19
Lithuania	12	25	37	16	1	9
Luxembourg	9	31	40	9	2	8
Macedonia	20	13	27	28	4	8
Malaysia	16	17	21	25	3	19
Mexico	29	21	33	13	1	3
Moldova	13	20	28	23	5	12
Netherlands	17	35	27	5	1	16
Nicaragua	62	8	18	6	2	4
Nigeria	27	9	10	30	21	3
Norway	5	55	24	9	1	6
Pakistan	29	27	16	5	2	21
Panama	40	8	27	17	3	5
Paraguay	33	14	33	15	1	4
Peru	35	13	24	8	1	19
Philippines	65	11	13	6	1	4
Poland	19	18	38	13	2	9
Portugal	19	20	25	19	9	8
Romania	9	5	36	31	5	13
Russia	26	24	34	7	1	8
Senegal	10	9	19	27	17	17
Serbia	21	15	33	17	3	12
Singapore	6	13	37	16	15	12
South Africa	27	11	19	22	14	7
South Korea	10	22	38	22	2	6
Spain	23	16	43	7	2	10
Switzerland	14	33	38	10	1	4
Taiwan	22	13	35	14	3	13
Thailand	24	13	21	26	9	8
Togo	24	10	16	18	23	11
Turkey	12	17	22	23	10	17
Ukraine	4	8	30	29	10	18
United Kingdom	18	28	36	9	2	8
Uruguay	5	4	21	44	13	13
USA	30	26	28	10	4	2
Venezuela	44	18	19		2	16
Total	**23**	**21**	**30**	**14**	**5**	**7**

Table 13: Experience of bribery: who paid a bribe in the past year?

In the past 12 months, have you or anyone living in your household paid a bribe in any form?	% Yes	% No	% Don't know / no answer
Argentina	6	92	3
Austria	4	82	13
Bolivia	20	79	1
Bosnia and Herzegovina	6	93	1
Bulgaria	7	88	5
Cambodia	36	62	2
Cameroon	43	46	11
Canada	1	98	0
Chile	3	95	2
Colombia	6	93	1
Costa Rica	4	96	1
Croatia	7	93	0
Czech Republic	18	74	8
Denmark	1	99	0
Dominican Republic	16	83	0
Ecuador	18	80	2
Ethiopia	30	69	0
Finland	3	90	7
France	2	96	3
Georgia	7	87	4
Germany	2	97	0
Ghana	21	69	10
Greece	12	87	0
Guatemala	25	73	2
Hong Kong	0	99	0
Iceland	1	98	1
India	12	87	1
Indonesia	11	84	4
Ireland	1	98	1
Israel	2	97	1
Japan	0	90	10
Kenya	19	59	22
Kosovo	9	89	3
Lithuania	28	64	9
Luxembourg	6	91	3
Macedonia	8	88	4
Malaysia	6	91	3
Mexico	31	65	5
Moldova	29	61	10
Netherlands	0	97	2
Nicaragua	5	95	0
Nigeria	29	69	2
Norway	4	92	4
Pakistan	13	67	19
Panama	9	90	1
Paraguay	43	51	6
Peru	14	78	8
Philippines	9	91	0
Poland	8	76	16
Portugal	2	97	1
Romania	22	64	15
Russia	17	81	1
Senegal	19	55	26
Serbia	19	74	7
Singapore	4	95	1
South Africa	5	91	3
South Korea	4	95	1
Spain	0	96	4
Switzerland	1	97	2
Taiwan	3	96	1
Thailand	6	93	1
Togo	30	60	10
Turkey	5	91	4
Ukraine	13	78	8
United Kingdom	1	99	1
Uruguay	3	97	1
USA	1	99	0
Venezuela	6	88	5
Total	**9**	**87**	**4**

Annex II

TI Global Corruption Barometer 2005 - Questionnaire

Now we would like to ask you a few questions about corruption. In this survey we are using corruption to mean the abuse of entrusted power – by a public official or a business person for example – for private gain. This could include material gain or other benefits.

1. Some people believe that corruption affects different spheres of life in this country. In your view, does corruption affect... not at all, to a small extent, to a moderate extent or to a large extent?

READ OUT AND ROTATE. SINGLE CODE FOR EACH

Spheres	Not at all	To a small extent	To a moderate extent	To a large extent	DK/NA	
Your personal and family life	1	2	3	4	9	Col 5
The business environment	1	2	3	4	9	Col 6
Political life	1	2	3	4	9	Col 7

2. In the past 3 years, how has the level of corruption in this country changed?

READ OUT AND ROTATE. SINGLE CODE

Increased a lot	1
Increased a little	2
Stayed the same	3
Decreased a little	4
Decreased a lot	5
DK/NA	9

3. Do you expect the level of corruption in the next 3 years to change? Will it:

READ OUT AND ROTATE. SINGLE CODE

Increase a lot	1
Increase a little	2
Stay the same	3
Decrease a little	4
Decrease a lot	5
DK/NA	9

4. To what extent do you perceive the following sectors in this country to be affected by corruption? Please answer on a scale from 1 to 5 (1 meaning not at all corrupt, 5 meaning extremely corrupt). Of course you can use in-between scores as well.
READ AND ROTATE. SINGLE ANSWER FOR EACH

Sectors	Not at all corrupt 1	2	3	4	Extremely corrupt 5	DK/NA
Customs	1	2	3	4	5	9
Education system	1	2	3	4	5	9
Legal system /Judiciary	1	2	3	4	5	9
Medical services	1	2	3	4	5	9
Police	1	2	3	4	5	9
Political parties	1	2	3	4	5	9
Parliament/Legislature	1	2	3	4	5	9
Registry and permit services (civil registry for birth, marriage, licenses, permits)	1	2	3	4	5	9
Utilities (telephone, electricity, water, etc.)	1	2	3	4	5	9
Tax revenue	1	2	3	4	5	9
Business/ private sector	1	2	3	4	5	9
Media	1	2	3	4	5	9
The military	1	2	3	4	5	9
NGOs (non governmental organizations)	1	2	3	4	5	9
Religious bodies	1	2	3	4	5	9

5. In the past 12 months, have you or anyone living in your household paid a bribe in any form?
INTERVIEWER: Living in household = people included in your house e.g. parents, children, etc

01 Yes
02 No
08 DK
09 NA

ASK ALL WHO ANSWERED YES IN Q5 – others go to Q6
5.1 What was the approximate amount of money paid overall in bribes by your household in the past 12 months?
To be asked in local currency but coded by interviewer as USD (or Euros).

1. Under 30 USD/approximately under 25 €
2. 30 - 49 USD/25 – 39 Euro
3. 50 - 74 USD/40 - 59 Euro
4. 75 - 99 USD/60 - 79 Euro
5. 100 – 149 USD/80 - 119 Euro
6. 150 – 199 USD/120 - 159 Euro
7. 200-299 USD/160 – 239 Euro
8. 300 – 499 USD/ 240 – 399 Euro
9. 500 – 749 USD/ 400 - 599 €
10. 750 – 999 USD/ 600 – 799 Euro
11. 1000 USD or more/ 800 Euro or more
12. DK/NA
13. Refused

ASK ALL WHO ANSWERED YES IN Q5 – others go to Q6
5.2. Which of the following applied to the bribes paid in the last 12 months:
READ AND ROTATE. SINGLE ANSWER FOR EACH

	YES	NO	DK/ NA
A bribe was directly asked for Col 28	1	2	9
A bribe was offered to avoid a problem with the authorities Col 29	1	2	9
A bribe was offered to receive a service entitled to. Col 30	1	2	9

TI Global Corruption Barometer 2005

Country coverage and country information

Country/ Territory	Contact	E-mail	Company	Mode	Sample Type	Sample size	Fieldwork Dates
Argentina	Ricardo Hermelo	ricardo.hermello@tns-gallup.com.ar	TNS Gallup Argentina	Face-to-face	National	1000	4th week of May
Austria	Ingrid lux	i.lusk@gallup.at	Gallup Austria	Face-to-face	National	668	May 31 – June 16
Bolivia	Luis Alberto Quiroga	Proyectos@encuestas-estudios.com	Encuestas & Estudios	Face-to-face	Urban	519	June 10 – June 25
Bosnia and Herzegovina	Aida Hadziavdic-Begovic	Aida.hadziavdic@mib.ba	Mareco Index Bosnia	Telephone	National	500	June 6 – June 10
Bulgaria	Antón Valkovski	A.valkovski@bbss-gallup.com	TNS BBSS	Face-to-face	National	1024	July 5 – July 12
Cambodia*	Hean Sokhom	sokhom@forum.org.kh	Center for Advanced Study	Face-to-face	National	600	October 9 - 20
Cameroon	Simplice Ngampou	Sngampou@rms-africa.com	RMS Cameroon	Face-to-face	Main cities	500	June 4 – June 6
Canada	Anne-Marie Marois	Ammarois@legermarketing.com	Leger Marketing	Telephone	National	1001	June 6 – June 15
Chile*	Paola Cea	mori4@morichile.cl	MORI (Chile) S.A.	Face-to-face	Urban	1200	August 25 -Sept 2
Colombia	Carlos Lemoine	Clemoine@cnccol.com	Centro Nacional de Consultoria	Face-to-face and telephone	Urban	500	July 8 – July 13
Costa Rica*	Hugo Mendieta	Hmendieta@apinvestigacion.com	API Sigma Dos	Telephone	Urban	500	May 23 – June 2
Croatia	Dragan Bagic	Drgan.bagic@puls.hr,	Puls	Telephone	National	600	June 1 – June 20
Czech Rep.	Jan Trojacek	Trojacek@mareco.cz	Mareco	Face-to-face	National	500	June 14 – June 27
Denmark	Claus Bo Hansen	Claus.Bo.Hansen@tns-gallup.dk	TNS Gallup Denmark	Telephone	National	500	June 8 – June 16
Dominican Republic*	Leonard Kemp	Sigmados@verizon.net.do	Sigma Dos Republica Dominicana	Face-to-face	Urban	806	July 12 – July 16
Ecuador	Carlos A. Cordova	Carlos.cordova@cedatos.com	Cedatos	Face-to-face	Main cities	500	June 27 – July 1
Ethiopia*	Margit Cleveland	Mcleveland@rms-africa.com	Research & Marketing Services	Face-to-face	Capital City	510	June 15 – June 21
Finland	Mika Kiiski	Mika.kiiski@tns-gallup.fi	TNS Gallup Finland	Telephone and Telepanel	National	1289	June 17 – June 22
France	Guillaume Rainsard	guillaume.rainsard@tns-sofres.com	TNS France	Face-to-face	National	1003	June 21 – June 22
Georgia	Merab Pachuia	mpachulia@gorbi.com	GORBI	Telephone	Main city	500	Aug-20-Aug 30
Germany	Johannes Huxoll	Johannes.huxoll@tns-emnid.com	TNS Emnid	Telephone	National	500	June 21 – June 29
Ghana*	Steve Ayo Amale	Aamale@rms-africa.com	Research & Marketing Services	Face-to-face	Urban	1005	June 10 – June 18
Greece	Ero Papadopoulou	ero.papadopoulou@tnsicap.gr	TNS ICAP	Telephone	National	500	June 2 – June 15
Guatemala*	Jorge Fernández	Multivexsa@intelnett.com	Multivex Sigma Dos Guatemala	Face-to-face	Urban	500	June 18 – June 20
Hong Kong	Ellen Tops	Ellen.tops@tns-global.com	TNS Hong Kong	Telephone	National	500	June 10 – June 19
Iceland	Ásdís G. Ragnarsdóttir	Asdisg@gallup.is	IMG Gallup	Telephone	National	1200	June 29 – July 26
India	Sharmistha Das	Sharmistha.das@tns-global.com	TNS India	Face-to-face	National	1063	June 1 – June 9
Indonesia	Pipit Andriany	Pipit.Andriany@tns-global.com	TNS Indonesia	Face-to-face	Main city	500	July 21 – July 27
Republic of Ireland	Patricia Kelly	Patricia.Kelly@imsl.ie	Millward Brown IMS	Telephone	National	500	May 18 – June 2
Israel	Tamar Fuchs	Tamar.fuchs@tns-teleseker.com	TNS Teleseker	Telephone	National	501	June 29 – June 30
Italy	Paolo Colombo	paolo.colombo@doxa.it	Doxa Italy	Telephone	National	502	July 28 – August 1
Japan	Kiyoshi Nishimura	Nisimura@nrc.co.jp	Nippon Research Center	Self-completed questionnaires	National	1212	June 2 – June 13
Kenya	Maggie Ireri	maggie@steadman-group.com	Steadman Research Services International	Face-to-face	National	2219	July 1 – July 9
Korea	Hwanhee Lee	Hhlee@gallup.co.kr	Gallup Korea	Face-to-face	National	1515	May 20 – June 3
Kosovo*	Assen Blagoev	A.Blagoev@gallup-bbss.com	BBSS Index Kosovo	Face-to-face	Albanian + sub-population	1023	May 26 – June 1
Luxembourg	Marc Thiltgen	Marc.thiltgen@ilres.com	Ilres	Telephone	National	582	June 24 –July 3
Lithuania*	Dainius Derkintis	Dainius.Derkintis@tns-global.com	TNS Gallup	Face-to-face	National	511	June 21– June 30
Macedonia	Elida Medarovska	E.medarovska@brima-gallup.com.mk	Brima	Face-to-face	National	1008	June 17– June 24
Malaysia	Hafeez Amin	Hafeez.amin@tns-global.com	TNS Malaysia	Face-to-face and Telephone	Urban	1250	May 30 – June 26
Mexico	Ramón Chaídez	Ramon.chaidez@tns-gallup.com.mx	TNS Gallup Mexico	Face-to-face	Urban	700	June 24 – June 29
Moldova	Igor Munteanu	*cbs_axa@yahoo.com*	CBS Axa	Face-to-face	National	509	June 24 – June 28
Netherlands	Hanneke Sjerps	Hanneke.sjerps@tns-nipo.com	TNS NIPO	Face-to-face	National	549	June 9 – June 21
Nicaragua*	Hugo Mendieta	Hmendieta@apinvestigacion.com	API Sigma Dos	Face-to-face	Urban	500	May 23 – June 2

Nigeria	Pradiptra Mitra	PKmitra@rms-africa.com	Services Limited	Face-to-face	Main cities	500	June 11 – June 20
Norway	Ole Fredrik Ugland	Olefredrik.ugland@tns-gallup.no	TNS Gallup Norway	Web-survey	National	510	June 1 – June 16
Pakistan	Ijaz Shafi Gillani	isb@gallup.com.pk	Gallup Pakistan	Face-to-face	Urban	843	June 1 – June 20
Panama*	Humberto Gonzalez	psicomer@pty.com	PSM Sigma Dos Panama	Telephone	Main city	500	June 6 –June 14
Paraguay*	Marlene Heinrich.	Cam@pla.net.py	CAM Research	Face-to-face	Main citiy	500	June 1 – June 25
Perú	Gustavo Yrala	Gyrala@datum.com.pe	Datum Internacional	Face-to-face	National	1112	June 11 – June 20
Philippines	Angel Almojuela	Angel.almojuela@asiaresearch.com.ph	Asia Research Organization	Telephone	National	1000	May 30 – June 19
Poland	Marek Fudala	Marek.fudala@mareco.pl	Mareco Polska	Face-to-face	National	908	June 14 – June 24
Portugal	Ana Firmino	Ana.firmino@tns-global.com	TNS Euroteste	Telephone	National	520	June 22 –June 28
Romania	Andrei Musetescu	Andrei.musetescu@tns-global.com	Csop	Face-to-face	National	1058	May 27 – June 5
Russia	Victor Pratusevich	Pratusevich.V@rmh.ru	ROMIR	Face-to-face	National	1006	May 18 – May 24
Senegal*	Erckman Togna	Etogna@rms-africa.com.	RMS-Senegal	Face-to-face	Urban	508	June 20 – June 23
Serbia	Sladjana Brakus	sladja@mediumindex.co.yu	TNS Medium Gallup	Face-to-face	National	1004	May 26 – June 1
Singapore	Petra Curbach	Petra.Curbach@tns-global.com	TNS Singapore	Telephone	National	502	July 4 – July 17
Spain	Rosa Doncel	rosad@sigmados.com	Sigma Dos International	Face-to-face	National	500	July 25 – August 2
South Africa	Mari Harris	marih@markinor.co.za	Markinor	Face-to-face	Urban	2000	June 9 – July 4
Switzerland	Barbara Spillmann	Barbara.spillmann@isopublic.ch	ISOPUBLIC	Telephone	National	500	June 1 – June 4
Taiwan	Kevin Meyer	Kevinmeyer@ort.com.tw	Opinion Research Taiwan	Telephone	National	500	June 16 – June 20
Thailand	Kulchat Wuttigate	kulchat.wuttigate@tns-global.com	TNS Thailand	Telephone	Urban	1000	July 19 – July 31
Togo*	Steve Ayo Amale	Aamale@rms-africa.com	Research & Marketing Services	Face-to-face	Main cities	488	June 28 – June 29
Turkey	Bengi Özboyacı	Bengi.ozboyaci@tns-global.com	TNS Piar	Face-to-face	National	2036	June 9 – July 1
UK	Emma Phillips	Emma.phillips@tns-global.com	TNS UK	Telephone	National	1031	June 3 –June 5
Ukraine	Alla Vlasyuk	Alla.vlasyuk@tns-global.com.ua.	TNS Ukraine	Face-to-face	National	1200	June 1 –June 7
Uruguay	José Luis Soto	marketing@adinet.com.uy	Sigma Dos Uruguay	Telephone	Main city	537	May 30 – June 24
USA	Jane Cutler	Jane.cutler@tns-global.com	TNS Intersearch	Telephone	National	504	June 29 – July 3
Venezuela	Romel Romero	Romel@sigmados-international.com	Sigma Dos Venezuela	Face-to-face	Main city	500	June 9 – June 24

*These are not Members of Gallup International Association but reliable companies that we have worked with in these countries.

TI Global Corruption Barometer 2005

Methodological note

The TI Global Corruption Barometer 2005 is a worldwide public opinion survey conducted for TI by Gallup International with 54260 respondents. The TI Global Corruption Barometer 2005 consists of a set of five questions included in the Voice of the People survey 2005, conducted in 69 countries by Gallup International members or partners. The TI Global Corruption Barometer is planned to be conducted annually.

Coverage

Overall, the Voice of the People survey was conducted in 69 countries, but some data were missing from individual countries because either the authorities did not give permission to conduct certain questions or technical problems during the field work.
In Italy, questions 5, 5.1 and 5.2 were omitted from the survey, and in Singapore, only the first part of question 5 was asked and not parts 5.1 - 5.2 - 5.3.

Timing of fieldwork

The fieldwork for the survey was conducted between May and October 2005.

Demographic variables

The demographic variables, Age, Education, Household income, Education, Employment, and Religion were recoded from their original form in the survey by Gallup International.

Sampling

The sample type is mostly national, but in some countries it is urban only. It should be underlined that in global terms the findings are quite heavily based on urban populations.
In most of the countries the sampling method is based on quota sampling, using sex/age/socioeconomic condition/regional/urban balances as variables. In some countries random sampling has been done.
The interviews were conducted either face to face or by telephone (mostly in developed countries) with male and female respondents, aged 15+ (this information is provided by country in Annex III of the report on the TI Global Corruption Barometer 2005).

Weighting

Sample imbalances in the data within a country (e.g. slight corrections to the proportions of age groups, sex, etc.) have been weighted first in order to provide a representative sample of the national population (or a representative sample of the stated universe, if this is not a total population sample). Subsequently, each country has been weighted to its relevant population (universe). For example, countries where only the urban population was interviewed were weighted up to a total urban population.

Data coding, quality check and analysis

The data coding and quality check, as well as preliminary analysis, was done by Gallup International.
The full report of the TI Global Corruption Barometer 2005 was completed by the Department of Policy and Research at the International Secretariat of TI.
A standard margin of error for the survey is +/- 4.

Additional statistical work was carried out by Prof. Johann Lambsdorff, of the University of Passau, on question 5, which explores the frequency of the public's experience of bribery. The paper looks at how the results from this Barometer question relate to the CPI, and includes recommendations on how the findings can be interpreted. This paper is downloadable at http://www.transparency.org/surveys/index.html#barometer